Missouri Sales and Use Tax Report

JOINT COMMITTEE ON TAX POLICY

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Background

Missouri initiated its sales tax on January 15, 1934 at a rate of .5%. The use tax, the equivalent companion of the sales tax, became effective on August 29, 1959. While the sales tax is a tax levied on goods and select services purchased in the state of Missouri, the use tax is levied on items purchased out of state and then brought into the state for consumption.

Prior to 1965, the sales and use taxes were excise taxes on the goods and services purchased; however, after 1965, Missouri reformed its sales and use tax system to a tax on gross receipts in which the seller of the good or service is responsible for the collection and remittance of the tax. It was then considered to be a tax on gross receipts of retail sales.

Sales at Retail

The Missouri statutes define a sale at retail as "an installment sale, credit sale, transfer, exchange, or barter of tangible personal property or taxable service for valuable consideration."[1] Sales at retail generally include: tangible personal property, admissions to entertainment or athletic events, utilities, telecommunication services, meals, beverages, lodging in public accommodations, intrastate transportation, and the rental of tangible personal property.

[1] This was taken from the University of Missouri's Economic Policy Analysis and Research Center's report on the Sales and Use Tax. The report is included as Appendix A.

Missouri exempts the following from the sales and use tax: those made by or to exempt organizations, sales that will later be resold and selected services and commodities.[2]

Court Cases Involving the Sales and Use Tax[3]

In recent years, Missouri has faced court challenges stemming from a variety of factors. The following court cases represent pertinent issues that affect Missouri's sales and use tax laws as well as the stability and vitality of the annual budget as well as education-specific funding.

Southwestern Bell Telephone Company v. Director of Revenue

Southwestern Bell, a telecommunications company, filed suit against the Director of Revenue for a return of sales tax paid on equipment (which includes handsets, wires, phone poles, switches, etc.) used to "manufacture" a telephone call. Citing the Court's decision, 'The standard for determining what is "used directly" has evolved as manufacturing itself has changed from traditional rust-belt factories to industries that are increasingly reliant what the AHC appropriately calls "technology of a new millennium."'

Incorporating the three-pronged integrated plant doctrine, the Court ruled in favor of Southwestern Bell by affirming that the equipment in question was "used directly" in manufacturing the product, in this case the voice transmission. The case reflected how

[2] For a complete listing of all the sales tax exemptions, please refer to Appendix B.
[3] Lowell Pearson, Deputy Director of the Department of Revenue, presented the following cases at a Joint Committee on Tax Policy hearing on September 13, 2006. The descriptions of the cases that follow merely capture the essence of the cases and do not reflect the various complexities of each one. Information from the cases was also gathered from memos from the Department of Revenue.

Missouri's current statutes represent more of manufacturing economy, while Missouri's business climate has shifted to more of a service-oriented technological economy.

Southwestern Bell, as well as other interested parties have claims of $300,000,000 (though all of these claims have not been substantiated) coupled with interest payments owed by Missouri of up to $150,000,000 totaling $450,000,000.

DST Systems, Inc. v. Director of Revenue

DST Systems Inc., a business which "provides information processing and computer software services and products"[4] filed suit against the Director of Revenue claiming they qualified for a sales tax exemption for some of the equipment that they purchased.[5] They successfully claimed that their mainframe computers as well as other equipment used primarily in their mutual funds operation were also used by a subsidiary corporation to conduct its package production operations. The Court, employing the "integrated plant doctrine,"[6] ruled that while the equipment and mainframe was not used exclusively to manufacture the product in question, it was, however, "substantially so used."

Six Flags Theme Parks, Inc. v. Director of Revenue

Six Flags Theme Parks, Inc. filed suit against the Director of Revenue claiming a sales tax refund on certain admission ticket and season pass sales (specifically tickets and season passes sold via telephone or mail to non-Missouri residents) and video game

[4] This description was taken from their company profile on DST System Inc. website at http://www.dstsystems.com/cp/cphm.html.
[5] DST Systems Inc. claimed the same exemption that Southwestern Bell claimed in the previous case, Section 144.030.2(5).
[6] The integrated plant doctrine refers to the notion that the Court 'views manufacturing operations as "continuous and indivisible."' This idea was also 'expanded to encompass two corporate entities under common ownership, so "long as both businesses work together to manufacture a single product.'" The previous quotes were taken from the Missouri Supreme Court ruling, DST Systems, Inc. vs. Director of Revenue.

receipts. The sales tax exemption that Six Flags Theme Parks, Inc. claimed for the ticket and season pass sales can be found in Section 144.030.1, RSMo, which claims an exemption for "such retail sales as may be made in commerce between this state and any other state of the United States." The Court, however, determined that the product being purchased by the out of state consumer was not the ticket or pass itself but rather it is "the sale of permission to enter a place of amusement and become the recipient of a service"[7] and as a result, the transaction does not take place in commerce between the states. This claim was denied by the Court.

Six Flags' claim against video game receipts, however, had a different outcome. They claimed, under Section 144.020.1(8), RSMo that a sales tax had already been paid on the purchase of the video game machine and therefore the rental or lease thereof by customers was not a taxable transaction. The Court agreed citing a prior case, Westwood Country Club v. Director of Revenue, in which the taxpayer successfully claimed that the rental of golf carts were not taxable transactions since a tax was already paid on the purchase of the golf cart by the Country Club. Employing the same logic, the Court ruled that the transaction between the customer and the video game machine was consistent with the rental or the lease of the machine and therefore was not subject to the Missouri sales tax.

Ronnoco Coffee v. Director of Revenue

The Ronnoco Coffee case involved three separate and distinct cases of which the Court ruled in one decision (one of the cases involved a separate coffee company, Rose Coffee Company). Prior to the Supreme Court hearing the case, the Administrative Hearing Commission had ruled in favor of the coffee companies and against the Director

[7] *Six Flags vs. Director of Revenue, 102 S.W.3d 526 (Mo.banc 2003).*

of Revenue on all three accounts. The Supreme Court had to decide whether or not to uphold the decision by the commission which had determined that the coffee companies were due the sales tax exemption.

The first of the three cases mentioned previously involved Ronnoco Coffee Company claiming an exemption under Section 144.615(6), RSMo.[8] Ronnoco Coffee company had purchased equipment used to make coffee and then developed a loan agreement with retailers, charging more for the coffee and less for the rental or loaning of the equipment used to produce the coffee. Their logic in claiming the exemption rested in the fact that they were reselling or loaning equipment (leasing) which they had already purchased therefore qualifying for the exemption listed above and described in the footnote below. In the second of the three cases, Rose Coffee Company claimed the same exemption as Ronnoco, and asked for a refund for use taxes paid on coffee equipment which was later resold, or more specifically, leased to retailers. The third case involved not a refund sought, but rather a dispute between the Director of Revenue and Ronnoco Coffee Company. After an audit by the Department of Revenue, the Director of Revenue claimed that Ronnoco was liable for sales and use tax on the same equipment discussed previously.

The crux of the case rested on the notion of whether or not the loan agreement developed by the coffee companies and their respective retailers qualified as a resale of tangible personal property. The Court upheld the decision by the Administrative Hearing Commission, stating "the fact that Coffee Companies' customers are required to return the equipment if the "loan agreement" is terminated does not defeat the fact that

[8] Section 144.615, RSMo lists exemptions to the sales/use tax. Subsection 6 reads "Tangible personal property held by processors, retailers, importers, manufacturers, wholesalers, or jobbers solely for resale in the regular course of business."

customers give consideration for the right to use the equipment under the terms of the agreement. Like the lessor's transactions in *Brambles,* Coffee Companies' transactions meet the definition of resale and are, therefore, exempt from the sales tax" (Ronnoco, 2003).[9][10]

Sales Tax on Services

According to the Federation of Tax Administrators, out of the list of 177 different services, Missouri levies a tax on thirty-nine or 28% of all services in the state.[11] In efforts to stabilize budget revenues and expand their sales and use tax base while reducing the burden of high tax rates, states have, in the past and in some cases recently, moved toward expanding their sales tax base to include services.

The state of Florida relies heavily on the sales and use tax for their budget revenues. In 1987, the state of Florida succeeded in expanding their sales tax base to include services. There was, however, a major backlash from across the country in how they expanded their sales tax base, largely from the business community. One of the most controversial aspects was the inclusion of advertising in the sales and use tax base. Essentially, under the legislation passed in 1987, businesses that bought and sold advertising in magazines, newspapers, radio, television, etc. would have to pay sales and use tax on that advertising. If the market included Florida as well as part of another state,

[9] Section 144.605(7) , RSMo states that a leases, rentals, bailments, loans, conditional sales or otherwise are all included in the definition of a sale and therefore a resale.

[10] *Brambles Industries v. Director of Revenue, 1998* helped set precedent regarding the issue of whether a lease constituted as a resale of property. The Court determined that it was, treating leases and sales as the same.

[11] For a more comprehensive review of sales tax on services, please refer to the Sales Tax on Services Report submitted to the Joint Committee on Tax Policy in October of 2005, available on the Joint Committee on Tax Policy website, or visit the Federation of Tax Administrator's website at http://www.taxadmin.org/fta/pub/services/services.html and use their searchable database.

then the business would have to apportion part of that advertising to Florida and the rest of the advertising to other states and pay the sales and use tax in Florida accordingly.

Lawsuits were filed against the state because the 1987 legislation taxed advertising which, they claimed, violated the first amendment of the Constitution in regards to freedom of speech, and taxed legal representation, which violated the right to counsel. Amidst the uproar from the business community and the national attention that Florida received as a result of their sales and use tax base expansion, Florida ultimately repealed the 1987 legislation the following year and instead increased the sales and use tax rate to increase budget revenues.[12]

In response to Florida's tax policy failure as well as the considerations of other states in expanding their sales and use tax to include services, economists began conjecturing about what the ideal sales and use tax structure should be. In 1988, Perry D. Quick and Michael J. McKee published an article which explained that Florida's recent foray into sales and use tax reform presents an opportunity for states to reform their tax structure for the most economically efficient as well as fair sales and use tax policy.

The Ideal Sales and Use Tax Structure

The authors of the article cited several dysfunctions with the sales tax structures of most states including: the unfairness of taxing goods and services while not applying the tax to other preferential goods and services as well as not exempting business to business transactions. The first dysfunction is more out of fairness- products in the

[12] The above information was taken from Walter Hellerstein's article, "Florida's Sales Tax on Services," published in the March 1988 edition of the National Tax Journal. For a much more comprehensive look at Florida's sales and use tax controversy, please refer to the aforementioned article included in the list of references.

market should be taxed fairly and equally[13], while the second dysfunction deals largely with economic efficiencies, i.e. avoiding tax pyramiding and vertical integration of large businesses as well as some fairness issues with small businesses[14] (who generally do not have the resources to vertically integrate).

To provide for the fairest and most economically efficient sales and use taxation, sales and use tax, according to the authors, should only be levied on goods and services sold to households or solely household consumption. They further argue that businesses will include the cost of the sales and use tax in the price of their product and household consumers ultimately pay the sales and use tax anyway.[15]

This reform option is also advocated by others as well. Hallerstein references the notion in his article.[16] Robert Cline, John L. Mikesell, Thomas S. Neubig, and Andrew Phillips explore and advocate for the idea in their February 2005 article, "Sales Taxation of Business Inputs: Existing Tax Distortions And the Consequences of Extending The Sales Tax to Business Services."[17] In another article written in January of 2005, "A Quality Index for State Sales Tax Structure- Measuring the States Against an Ideal Standard," John Mikesell employs a tax on household consumption as the ideal sales tax structure and measures how closely each of the forty-five states that levy a sales tax live up to that standard.[18]

[13] Quick and McKee, p. 395.
[14] Quick and McKee, p. 396.
[15] Quick and McKee, p. 397-399.
[16] Hallerstein, p. 8.
[17] Within the article, the authors calculate the share of revenue generated from business inputs to be 44.9%, nearly 2% above the average of the states- 43%.
[18] According to the report, out of a possible perfect score of 526.66, Missouri falls short scoring 416.9.

The idea is also reinforced by the Tax Foundation's 2007 State Business Tax Climate Index.[19] The index ranks each state on its overall tax policy by developing indexes and sub-indexes for each of the major taxes. In regards to the sales and use tax, Missouri, according to the study, does a good job of avoiding much of tax pyramiding by exempting many specific business to business transactions, ranking comparatively well against other states; however, there are still some business to business transactions that are taxed.

Some argue, however, that such a system of exempting business to business transactions would be difficult to administer. Michael Mazerov of the Center on Budget and Policy Priorities contended that "business owners could claim purchases of many services — such as telecommunications, hotel rentals, and auto and computer repair — to be for business use when they were actually for personal use. Preventing this abuse would require that substantial additional resources for tax enforcement be provided to state tax departments. The costs of preventing tax evasion could exceed the economic benefits of exempting business inputs from taxation."[20]

Quick and McKee, however, do offer a suggestion for implementing this sales and use tax policy- issue business ids which would allow businesses to make exempt business to business transactions. The transactions would have to need to be recorded, but the authors suggest that this is not an entirely new record-keeping method as businesses must account for purchases by the federal government as well as exempt or non-profit organizations.[21]

[19] An executive summary of the 2007 State Business Tax Climate Index is included as Appendix G.
[20] Mazerov, p.4.
[21] Quick and McKee, p. 402-403.

Streamlined Sales and Use Tax Agreement[22]

Quill Corporation v. North Dakota[23]

In 1992, the United States Supreme Court ruled on the decision *Quill Corp. v. North Dakota*. North Dakota had required that Quill Corporation, an out-of-state catalogue business, collect a use tax on items sold to customers in North Dakota. The case rested on the notion of nexus, or essentially, the relationship between a businesses and a state. Ultimately, the court ruled that nexus with a state is not established based solely on the fact that the business had customers in the state. In order for nexus to be established, according to the court, there had to be a physical presence by the business in the state- i.e. physical structures and employees.

Largely, the Supreme Court was wary that it would be administratively difficult for any business that was a remote seller to navigate the sales and use tax structures of the 45 states as well as Washington D.C. that all have a sales tax (Alaska, Delaware, New Hampshire, Oregon, and Montana do not levy sales and use taxes). Basically, the Supreme Court would not require remote sellers to collect sales and use taxes until simplification and uniformity were brought to these sales tax structures.

The explosion of the internet caused many more transactions to be conducted by remote sellers via electronic commerce. This has caused many states to look to the future to see where the future of sales and use taxation is heading.

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[22] Joan Wagnon, Director of the Kansas Department of Revenue testified before the committee via teleconference call on December 5, 2005 about the experiences that Kansas has had in implementing the Streamlined Sales and Use Tax Agreement. Chuck Surface of the Missouri Association of Counties expressed his support for SSUTA at the same meeting. An outline of all recent sales tax testimony is included as Appendix D.

[23] This information was obtained from the Tax Foundation's blog site as a brief. The citation is included in the list of references.

Streamlined Sales and Use Tax Project[24]

In March of 2000, states banded together to create the Streamlined Sales and Use Tax Project, an organization dedicated to making the sales and use tax structures in the various states more uniform and easier to administrate. The product of the organization's efforts became the Streamlined Sales and Use Tax Agreement. Adopted in November of 2002, the agreement addresses how states should structure their sales and use taxes. The following represents the major requirements of the uniform and simplified sales and use tax:

1. *State Level Administration*- the state administers the sales and use tax[25]
2. *Conformity of General Tax Base Definitions*- states must adopt general tax base definitions; however, definitions may vary somewhat from one state to another
3. *State and Local Tax Base*- a uniform state and local government tax base[26]
4. *State and Local Tax Rates*- one single state rate for the whole state (special exemptions include sales of food, food ingredients, and prescription drugs) and one single local rate for each local jurisdiction (tax boundaries are drawn by zip code)[27]
5. *Uniform Sourcing Rules*- generally this is destination-based sourcing[28]

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[24] Much of the following information was gathered from an online brief detailing the specifics of the agreement. The website from where this information came was http://www.pmstax.com/state/bull0211.shtml.

[25] Missouri currently administers the sales and use tax for the state and local governments.

[26] Missouri currently allows a different sales tax base for state and local governments.

[27] This would represent a significant undertaking for Missouri because local taxing jurisdictions (which do not have boundaries set by zip codes) can set their own rates. A list of all taxing jurisdictions their rates can be found on DOR's website. The web address is http://www.dor.mo.gov/tax/business/sales/rates/2006/

[28] Missouri's current system is origin-based sourcing. The large amount of Missouri's local taxing jurisdictions' sales tax rates makes destination-based sourcing administratively complex for businesses in Missouri as well as other states.

6. *Uniform Exemption Certificates*- states must adopt a uniform certificate both for tax-exempt entities and specific tax exemptions
7. *Simplification in Returning and Remitting Taxes*- one tax return is filed per tax period for each state and one payment is made to each state, regardless of the local levels; in addition, the agreement allows businesses to utilize a certified service provider (a collector and administrator of sales taxes) for their business. These certified service providers, or CSPs, would be designated by the state.
8. *Consumer Protection Privacy*- CSPs are required to not retain information obtained from consumers when performing their service to businesses; should an exemption be used, states are required to discard the consumer information once the exemption has been determined to be valid.[29][30]

Participating States

States participating in the agreement fall under three categories: full member states, associate member states, or observer states. Full member states are in complete compliance with the agreement. Associate member states are generally in compliance or are scheduled to be in compliance with the agreement by January 1, 2008. Observer states are interested in the project, but not in compliance with the agreement.

Full member states include: Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, South Dakota, and West Virginia. Associate member states include: Arkansas, Nevada, Ohio,

[29] These 8 provisions only represent the major provisions. For a full copy of the agreement, please refer to the SSUTA website at http://www.streamlinedsalestax.org/SSUTA%20As%20Amended%2008-30-06.pdf.
[30] An executive summary of the Streamlines Sales and Use Tax Agreement is attached as Appendix E.

Tennessee, Vermont, Utah, and Wyoming. Observer states include the remaining states with the exception of Alaska, Delaware, Idaho, Montana, and New Hampshire.[31]

Transportation Development Districts

The State Auditor's Office completed an audit of the Transportation Development Districts, otherwise known as TDDs, throughout the state of Missouri. Transportation development districts, according to the audit, "are separate political subdivisions established and organized for the construction of roads, bridges, interchanges, or other transportation-related projects, financed through the issuance of notes, bonds, or other debt securities and governed by a board of directors. These boards have the authority to impose sales taxes or tolls, or levy property taxes or special assessments within the boundaries of the respective TDDs to pay those transportation-related project expenditures." While the audit covers a variety of issues involving the creation and administration of TDDs, the issue pertinent to the realm of taxation is embedded in the collection of sales and use taxes.

The State Auditor's Office reported that the Department of Revenue does not collect the sales tax revenues associated with TDDs unless the TDD encompasses an entire county or city. The collection of sales and use taxes are performed either by a private contractor or the local municipality. As of the audit, the Department of Revenue performs the collection function for one TDD; the remaining eighty-six TDDs in existence (as of October, 2005) employ the other options. Charging the Department of Revenue with collecting the sales and use tax of TDDs, according to the audit, would

[31] Information obtained from the Streamlined Sales and Use Tax Project website at http://www.streamlinedsalestax.org/ssutachart2.pdf on October 18, 2006.

subject the sales tax collections to "established controls and procedures to maximize and safeguard this process" as well as "allow the sales tax revenues distributed to TDDs to be more effectively monitored by auditors and other outside parties to help ensure the sales tax collections are discontinued at that time when no further collections are needed."[32]

[32] These quotes were taken from the State Auditors Office audit on Transportation Development Districts from March 2006. The page concerning the collections of TDDs' revenues is included as Appendix F.

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Six Flags v. Director of Revenue 102 S.W.3d 526 (Mo.banc 2003).

Southwestern Bell Telephone Company v. Director of Revenue SC86441. (Mo.banc 2005).

Sales and Use Tax

The Missouri sales tax became effective January 15, 1934. The tax rate was one-half percent. The Missouri use tax was enacted effective August 29, 1959. The use tax is an equivalent tax to the sales tax, imposed on the privilege of using, consuming or storing property purchased in another state.

In 1965, the sales tax statutes were revised to change the tax from an excise tax imposed upon the purchaser to a gross receipts tax imposed upon the seller. The sales tax is considered to be a levy on the privilege of making retail sales. The value of this privilege is measured by the gross receipts from the retail sales of tangible personal property and certain services within Missouri. Sales of property and services to Missouri residents from other states are not currently taxed, unless the vendor use tax is applicable.

Appendix II contains a historical summary of sales tax rates. The tax expenditures for sales and use taxes detailed in the study are calculated using a tax rate of 3 percent, which is the current General Revenue Fund levy. As a consequence, they do not reflect the temporary rate increase during 1989 and 1990. The impact on other state fund revenues that are financed by this tax source have not been tabulated. They would, however, be proportional to their respective tax rates.

The sales and use tax as defined by Chapter 144, RSMo, 1986 and 1993 Supplement, is imposed on gross receipts that generally include the sale at retail of or charges for:

(1) tangible personal property;
(2) admissions to places of amusement, entertainment and recreation, games and athletic events;
(3) utilities, including telecommunication service;
(4) meals, beverages and lodging in public accommodations;
(5) intrastate transportation; and
(6) rental of tangible personal property.

The "sale at retail" for purposes of the Missouri sales tax law is defined as an installment sale, credit sale, transfer, exchange or barter of tangible personal property or taxable service for valuable consideration.

Exempt sales fall into three broad categories:

(1) those made by or to tax exempt organizations,
(2) sales for further resale and
(3) selected services and commodities.

The first set consists of a variety of nonprofit organizations including religious, charitable, educational and fraternal organizations (see Exhibit 8). These organizations are also exempt from the corporation income tax.

The provisions of the second category exempts the sale of commodities that are intended for further resale. This provision is intended to eliminate the "tax on a tax" or cascade effect on firms selling intermediate products.

Sales and Use Tax
by Calendar Year

2003 Rank: 2
2003 Tax Rate: General Fund— 3.0%
Other*— 1.225%

	2001	2002	2003
Gross Receipts			
General Fund	1,837.0	1,818.5	1,829.6
Other*	NA	NA	NA
Tax Expenditures			
Exclusions	1,666.5	1,696.4	1,755.7
Deductions	0.0	0.0	0.0
Credits	30.9	31.3	32.3

*Figures in millions of dollars; *Includes School District Fund, Conservation Fund, and Soil and Water Conservation Fund.*

The final group of exempt sales consists of services and commodities that receive specific preferential treatment. These exemptions may be categorized into one of two types of sales. The first is export sales—retail sales shipped to another state. These are excluded because of current federal statutes. The second, and by far largest category, includes most consumer services that were tacitly excluded from the Missouri sales tax statute. Among these are:

- Household maintenance & repair services
- Housekeeping services
- Apparel services
- Vehicle maintenance & repair services
- Medical services
- Personal care services
- Other personal and educational services

Exhibit 10 contains estimates of the revenue effects of sales and use tax exemptions.

Readers will notice that this list is far more pervasive than the exemptions contained in current Missouri statutes. This is the result of the implicit definition of taxable services. The latter places a very narrow definition on such activities. As a result, such services as medical care, legal representation, personal care, and college tuition are not subject to the tax. Exhibit 10, however, includes estimates of the revenues such activities would generate.

Exhibit 8
Tax-Exempt Organizations
as of November 2003

Section of Internal Revenue Code (if applicable) and Statute Reference	Description of Tax-Exempt Organization	Description of Exemption	Number of Organizations
IRC 501(c)(3) Section 144.030.2(19)	Religious Example: Churches	Sales made by or to such organizations solely in their religious, charitable or educational function	22,760
IRC 501 (c)(3) Section 144.030.2(19)	Charitable Example: American Heart Association	Sales made by or to such organizations solely in their religious, charitable or educational function	10,037
IRC 501 (c)(3) Section 144.030.2(19)	Educational (elementary and secondary public schools) (Also see political subdivisions)	Sales made by or to such organizations solely in their educational functions and activities	2,909
IRC 501(c)(4) IRC 501(c)(7) IRC 501(c)(8) IRC 501 (c)(10) Section 144.030.2(20)	Civic, social and fraternal (promotion of community, welfare; charitable, educational or recreational)	Sales made by or to such organizations solely in their civic or charitable functions and activities	11,452
Section 144.030.2(20)	Eleemosynary and penal institutions and industries of the state Example: State penitentiary produces license plates	Sales made to	NA
Section 144.030.2(20)	Not-for-profit institution of higher education	Sales made to	740
Section 144.030.2(20)	State relief agencies in their exercise of relief functions	Sales made to	NA
Section 144.030.2(20)	Private not-for-profit elementary or secondary schools not excluded elsewhere	Sales made to	185
IRC 501(c)(5) Section 144.030.2(21)	Benevolent, scientific and educa-tional associations encouraging science of agriculture	Sales made by	NA
IRC 501(c)(5) Section 144.030.2(21)	Not-for-profit summer theatre organizations	Sales made by	NA
Section 144.010 Section 144.030	U.S. government and agencies	Sales made to	see next line
Section 144.010 Section 144.030	Missouri political subdivisions (political & federal government)	Sales made to	8,308
Section 144.010 Section 144.030	State of Missouri	Sales made to	111
Section 144.270	Rural water districts	Sales made to	NA
Section 144.010 Section 144.030	Non-appropriated activities of military service	Sales made to	NA

NA - Not available

Exhibit 9
Derivation of Missouri Taxable Sales—Sales Tax

Gross Receipts or Sales

less

Adjustments

- Sales for resale
- Value of trade-in
- Goods shipped out of Missouri
- ✓ Food for home consumption
- ✓ Motor fuel, special fuel, other fuel
- Government, religious, educational, charitable institutions
- ✓ Drugs, oxygen, insulin, prosthetic or orthopedic devices
- ✓ Farm machinery
- ✓ Water, electricity, gas, wood, coal or home heating oil
- ✓ Seed, fertilizer, grain, economic poisons, livestock/poultry feed
- ✓ Labor or service charges when separately billed
- ✓ Other adjustments

equals

Taxable Sales

- Multiplied by effective tax rate

equals

Gross Amount Tax Due

less

Credits

- ✓ Timely payment discount

equals

Net Amount of Tax Due

✓ - *Tax expenditure*

Exhibit 10
Sales and Use Tax Expenditures
1998-2008

		1998	1999	2000	2001	2002	2003[P]	2004[F]	2005[F]	2006[F]	2007[F]	2008[F]
Personal Exemptions												
Non-Durable Commodities												
B.01	Drugs and Medical Commodities											
	Prescription Drugs	62.5	71.4	81.2	77.3	81.3	87.0	91.9	96.8	101.7	106.5	111.5
	Nonprescription Drugs	•	•	•	•	•	•	•	•	•	•	•
B.07	Motor Fuel*	112.6	124.4	171.4	164.7	153.3	173.8	177.4	181.1	184.8	188.7	192.6
B.28	Lottery Tickets	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.31	Food for Home Consumption	206.1	218.2	230.7	216.5	219.0	226.4	231.4	236.3	241.2	246.2	251.1
B.32	Textbooks	0.3	2.3	2.8	2.9	3.0	3.1	3.2	3.3	3.5	3.6	3.7
Services												
B.04	Domestic Utilities	103.8	106.0	114.7	107.3	108.7	109.7	110.9	112.1	113.2	114.5	115.7
A.03a	Household Maintenance/Repair	26.2	28.0	29.1	25.7	25.2	24.8	24.3	23.9	23.4	22.9	22.5
A.03b	Housekeeping	9.6	8.9	9.6	7.5	6.9	7.2	7.1	7.0	6.8	6.7	6.6
A.03c	Apparel	13.9	14.8	15.9	14.5	14.8	14.9	15.2	15.4	15.6	15.8	16.1
A.03d	Vehicle Maintenance/Repair	15.2	16.0	17.0	15.5	15.8	16.0	16.2	16.4	16.7	16.9	17.1
B.05	Transportation Fares	30.4	31.8	34.2	30.4	29.8	30.1	29.9	29.7	29.6	29.4	29.3
A.03e	Medical Care	501.3	522.9	552.8	524.3	547.6	566.0	586.8	607.6	628.4	649.2	670.0
A.03f	Personal Care	56.3	60.3	64.8	58.8	60.0	60.7	61.6	62.5	63.5	64.4	65.3
A.03g	Other Personal & Educational	402.0	436.4	477.9	417.0	426.8	431.6	438.8	446.1	453.3	460.6	467.8
Miscellaneous												
A.01	Isolated/Occasional Sales	3.3	3.6	3.9	4.1	4.2	4.4	4.7	5.0	5.4	5.8	6.2
B.23	Handicraft Items/Senior Citizen	•	•	•	•	•	•	•	•	•	•	•
Business Exemptions												
Agriculture												
B.08	Fuel Used for Drying Crops	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.09	Agricultural Diesel Fuel	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.10	Farm Machinery and Equipment	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.11	Repair Farm Machinery	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.12	Baling Wire, Baling Twine	•	•	•	•	•	•	•	•	•	•	•
B.13-14	Feed, Seed, Fertilizer, Pesticides, Etc.	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Mining and Manufacturing												
B.16	Replacement Machinery	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.17	New or Expanded Plant	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.21	Electrical Energy	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA

*Figures in millions of dollars; * = Applies to General Revenue Funds Only NA = Not available; ⁙ = Not applicable; • = Less than $50,000 (Excludes Business Sales)*
P = Preliminary numbers ; F = Forecasted numbers

Exhibit 10 (continued)
Sales and Use Tax Expenditures
1998-2008

		1998	1999	2000	2001	2002	2003[P]	2004[F]	2005[F]	2006[F]	2007[F]	2008[F]
Mining and Manufacturing												
B.22	Pollution Control Equipment	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.24	Anodes	•	•	•	•	•	•	•	•	•	•	•
B.26	Electric and Gas for Steel & Cellular Glass	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.33	Drug Research and Development	×	×	×	×	×	×	×	×	×	×	×
Transportation and Utilities												
A.04	Delivery Charges	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.15	Common Carriers–Replacement Parts	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.19	Pipeline Pumping Equipment	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.20	Railroad Rolling Stock	•	•	•	•	•	•	•	•	•	•	•
B.27	Barge Fuel	•	•	•	•	•	•	•	•	•	•	•
Other												
A.06	Custom Design Software	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
A.07	Advertising	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.06	Government Suppliers and Contractors	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.25	Fees Paid to a Municipality	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
B.29	Bingo Equipment	•	•	•	•	•	•	•	•	•	•	•
B.30	Tax Exempt Institutions	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Credits												
C.01	Timely Payment	29.4	31.1	32.9	30.9	31.3	32.3	33.0	33.7	34.4	35.1	35.8

*Figures in millions of dollars; * = Applies to General Revenue Funds Only NA = Not available; × = Not applicable; • = Less than $50,000 (Excludes Business Sales)*
P = Preliminary numbers ; F = Forecasted numbers

Exemptions of the Missouri Sales Tax

Personal Sales

1. Occasional or isolated sales as long as gross receipts do not exceed $3,000 in a given year
2. Computer printouts, outputs, microfilm, and microfiche for personal use
3. Handicraft items sold by senior citizens if the income does not constitute a majority of the annual gross income of the seller
4. Sales for resale

Property Transfers and Sales

5. Transfer of property as a result of a merger or consolidation
6. Transfer of property for liquidation or cessation
7. Transfer of property for stock or securities
8. Transfer of property from a shareholder to a corporation
9. Transfer of property for a partnership interest
10. Transfer of property from a partner to the partnership
11. Transfer of property from corporation to shareholder as a dividend
12. Transfer of property from a partnership to a partner
13. Bullion and investment coins
14. Intangible personal property
15. Real estate and fixtures
16. 40% of the price of a new manufactured home
17. Trade-in value of item to be subtracted from the taxable value of new item
18. Motor vehicle, trailer, boat if the seller purchases a subsequent vehicle within 180 days of sale
19. Insurance proceeds plus the amount of deduction for purchase of a motor vehicle, boat, trailer, etc.
20. Light aircraft, light aircraft kits, etc. purchased by a non-Missouri resident

Sales Made between or through Government Entities

21. Sales between Missouri and another state or foreign country
22. Personal property or products sold to the U.S. Government
23. Sales at retail made through vouchers or coupons through the women, infants, and children program
24. Sales or transfers of personal property to one who leases from an interstate compact agency
25. Property paid for by political subdivisions
26. Tangible personal property purchased through a state senator’s or state representative’s expense account
27. Court transcripts and depositions prepared by a court reporter
28. Sales at retail made through the use of federal food stamp coupons
29. Tangible personal property purchased by a rural water district

Manufacturing Sales

30. Individual component parts or ingredients used to create a retail product
31. Steel products used to create a retail product
32. Materials, replacement parts, and equipment used for common carriers
33. Replacement machinery, parts, equipment used to produce a retail product
34. Machinery, parts, etc. for recycling plants
35. Machinery, equipment, etc. for expansion of existing manufacturing, mining, or fabricating plants
36. Cellulose casings for hotdogs if the manufacturer recycles the casings
37. Fuel used to create a product to be sold for retail
38. Electrical energy or gas used to make steel products
39. Electrical current for battery manufacturers
40. Electrical energy used to produce a retail product
41. Anodes

Media Related Sales

42. Products used for producing newspapers
43. Rentals of sound or pictures used for public commercial display
44. Equipment purchased by a federally licensed broadcast station

Transportation Related Sales

45. Products associated with pipelines as common carriers
46. MoDOT Sales
47. Aircraft to common carriers for interstate commerce
48. Purchase of storage by interstate air transportation
49. Aviation jet fuel (expired December 31, 2003)
50. Railroad rolling stock
51. Motor vehicles and common carrier trailers used for transportation of persons or retail property
52. Sales made to the Bi-Development Agency or the Kansas City Area Transportation Agency
53. Motor fuel or special fuel
54. Sales of fuel used for the operation of ships, barges, or waterborne vessels on water
55. Boats or vessels documented by the U.S. Coast Guard
56. Barges
57. Sale, storage, use, or consumption of aviation jet fuel

Pollution

58. Products used to reduce or monitor air pollution
59. Products used to reduce or monitor water pollution

Pharmaceutical, Medical or Disability Related Sales

60. Insulin
61. Prosthetic and orthopedic devices

62. Prescribed drugs
63. Medical oxygen
64. Hospital beds and accessories
65. Ambulatory aids (wheelchairs, stair lifts)
66. Braille writers and Braille equipment
67. Scooters, reading machines, and electronic print enlargers for the disabled
68. Electronic communication devices
69. Motor vehicle modification items for disabled persons
70. Nonprescription drugs for persons with disabilities
71. Tangible personal property purchased by life science companies
72. Property purchased for the research and development of prescription pharmaceutical products

Organizations or Entities

73. Sales made by or to religious or charitable organizations
74. Sales made by or to elementary and secondary schools
75. Sales made to private not-for-profit elementary or secondary schools
76. Sales made to or by civic, service, social, or fraternal organizations
77. Initiations or dues paid to organizations
78. Sales made to eleemosynary or penal institutions
79. Sales made to private non-for-profit institutions of higher education
80. Sales to a state relief agency
81. Construction, repair, or maintenance of exempt organizations' facilities

Tickets or Admissions

82. Ticket sales by benevolent, scientific, or educational associations
83. Admissions for public zoos, fairs, museums, and planetariums
84. Ticket sales by nonprofit summer theatre organizations
85. Admission charges to the Missouri State Fair
86. Admissions to the 1994 World Cup Soccer Tournament
87. Admissions to the 1994 U.S Olympic Festival
88. State Fair Exhibit Entry fees
89. Tickets to a collegiate athletic championship event
90. Gambling boat admission fees

Agricultural Sales

91. Feed additives, medications, or vaccines used in the production of food or fiber
92. Pesticides used for production of crops, poultry, food, fiber, etc.
93. Pesticides or herbicides used in the production of crops, livestock, etc.
94. Pesticides used to create a retail product
95. Bedding used for the production of livestock or poultry
96. Natural gas used for ethanol production
97. Natural gas, propane, and electricity used for new generation processing (alternative fuel production)
98. Propane or natural gas, electricity, or diesel fuel used for drying agricultural crops
99. New or used farm machinery and equipment used to produce retail products

100. Grain bins
101. Feed for livestock which will produce a retail product
102. Livestock
103. Animals or poultry used for feeding or breeding
104. Seed, limestone, or fertilizer used to create a retail product
105. Aircraft used for the aerial application of agricultural chemicals

Utilities

106. State sales tax on utilities used domestically
107. Utilities associated with producing cellular glass products or recycled products
108. Telephone surcharges

Miscellaneous

109. Computers, computer software, and computer security systems purchased for use by architectural or engineering firms with headquarters in Missouri
110. Feed for pets owned by a commercial breeder
111. Reusable containers for which a deposit and return is required
112. Restaurant items furnished to customers that are not reusable
113. Hotel items furnished to customers that are not reusable
114. Tax on food to be 1% (education) plus .225% (conservation fund)
115. Purchases by a contractor on behalf of an entity located in another state
116. Materials purchased by a contractor for an entity with project exempt certificates
117. Non-domestic game birds sold for the purpose of sport hunting
118. Sales Tax Holiday
119. Excise taxes collected at the time of retail sale
120. Textbooks to college students- state sales tax only
121. Coin operated amusement and vending machines
122. Advertising services
123. Bingo supplies to licensed organizations

	MISSOURI SALES TAX EXEMPTIONS revised (11/06)	Statute
1.	The ***isolated or occasional sale*** of tangible personal property, service, substance, or thing, by a person not engaged in such business, unless the total amount of the gross receipts from such sales, exclusive of receipts from the sale of tangible personal property by persons which property is sold in the course of the partial or complete liquidation of a household, farm or nonbusiness enterprise, exceeds three thousand dollars in any calendar year	144.010.1(2)
2.	Sales of ***computer printouts, computer output or microfilm*** or microfiche and computer-assisted photo compositions to a purchaser to enable the purchaser to obtain for his or her own use the desired information contained in such items	144.010.1(10)
3.	The transfer by one corporation of substantially all of its tangible personal property to another corporation pursuant to a ***merger or consolidation*** effected under the laws of the state of Missouri or any other jurisdiction	144.011.1(1)
4.	The transfer of tangible personal property incident to the ***liquidation or cessation*** of a taxpayer's trade or business, conducted in proprietorship, partnership or corporate form, except to the extent any transfer is made in the ordinary course of the taxpayer's trade or business	144.011.1(2)
5.	The transfer of tangible personal property to a corporation solely in exchange for its ***stock or securities***	144.011.1(3)
6.	The transfer of tangible personal property to a corporation by a shareholder as a ***contribution to the capital*** of the transferee corporation	144.011.1(4)
7.	The transfer of tangible personal property to a partnership solely in exchange for a ***partnership interest*** therein	144.011.1(5)
8.	The transfer of tangible personal property by a partner as a ***contribution to the capital*** of the transferee partnership	144.011.1(6)
9.	The transfer of tangible personal property by a corporation to one or more of its ***shareholders*** as a dividend, return of capital, distribution in the partial or complete liquidation of the corporation or distribution in redemption of the shareholder's interest therein	144.011.1(7)
10.	The transfer of tangible personal property by a partnership to one or more of its ***partners*** as a current distribution, return of capital or distribution in the partial or complete liquidation of the partnership or of the partner's interest therein	144.011.1(8)
11.	The transfer of ***reusable containers*** used in connection with the sale of tangible personal property contained therein for which a deposit is required and refunded on return	144.011.1(9)
12.	The purchase by persons operating ***eating or food service establishments***, of items of a nonreusable nature which are furnished to the customers of such establishments with or in conjunction with the retail sales of their food or	144.011.1(10)

	beverage	
13.	The purchase by persons operating ***hotels, motels or other transient accommodation establishments***, of items of a nonreusable nature which are furnished to the guests in the guests' rooms of such establishments and such items are included in the charge made for such accommodations	144.011.1(11)
14.	Charges for ***initiation fees or dues*** to: (a) Fraternal beneficiaries societies, or domestic fraternal societies, orders or associations operating under the lodge system a substantial part of the activities of which are devoted to religious, charitable, scientific, literary, educational or fraternal purposes; or (b) Posts or organizations of past or present members of the armed forces of the United States or an auxiliary unit or society of, or a trust or foundation for, any such post or organization substantially all of the members of which are past or present members of the armed forces of the United States or who are cadets, spouses, widows, or widowers of past or present members of the armed forces of the United States, no part of the net earnings of which inures to the benefit of any private shareholder or individual	144.011.1(13)
15.	State tax imposed on ***food*** shall be at the rate of one percent (plus constitutionally imposed tax of .225%)	144.014
16.	The value of ***any item traded-in***, which is subtracted from the taxable amount of the item purchased	144.025
17.	The price of any ***motor vehicle, trailer boat or outboard motor sold by the owner*** if the owner purchases a subsequent motor vehicle, trailer, boat or outboard motor within 180 days before or after the date of the sale of the original article	144.025
18.	The amount of the ***insurance proceeds*** plus any owner's deductible obligation, as certified by the insurance company, which is a credit against the purchase price of another motor vehicle, trailer, boat or outboard motor which is purchased or is contracted to purchase within one hundred eighty days of the date of payment by the insurance company as a replacement motor vehicle, trailer, boat or outboard motor	144.027
19.	Sales ***in commerce*** between this state and any other state or between this state and any foreign country	144.030.1
20.	***Motor fuel*** or special fuel subject to an excise tax of this state, unless all or part of such excise tax is refunded pursuant to §142.584	144.030.2(1)
21.	***Fuel to be consumed in*** manufacturing or creating gas, power, steam, electrical current or in furnishing water to be sold ultimately at retail	144.030.2(1)
22.	***Feed for livestock or poultry*** which is to be used in feeding of livestock or poultry to be sold ultimately in processed form or otherwise at retail. ***Livestock*** includes cattle, calves, buffalo,	144.030.2(1) 144.010.1(4)

	Ilamas, Alpaca, sheep, swine, ratite birds (ostrich and emu), aquatic organisms, elk documented as obtained from a legal source and not from the wild, goats, horses, other equine and rabbits raised in confinement for human consumption.	
23.	***Seed, limestone or fertilizer*** which is to be used for seeding, liming or fertilizing crops which when harvested will be sold at retail or will be fed to livestock or poultry to be sold ultimately in processed form at retail	144.030.2(1)
24.	Economic poisons registered under the provisions of the Missouri ***pesticide*** registration law which are to be used in connection with the growth or production of crops, fruit trees or orchards applied before, during, or after planting, the crop of which when harvested will be sold at retail or will be converted into foodstuffs which are to be sold ultimately in processed form at retail	144.030.2(1)
25.	Materials, manufactured goods, machinery and parts which when used in manufacturing or fabricating become a ***component part or ingredient*** of the new personal property resulting from such manufacturing, processing compounding, mining, producing or fabricating and which new personal property is intended to be sold ultimately for final use or consumption	144.030.2(2)
26.	Materials, including without limitation, gases and manufactured goods, including without limitation, slagging materials and firebrick, which are ultimately consumed in the manufacturing process by blending, reacting or interacting with or by becoming, in whole or in part, component parts or ingredients of ***steel products*** intended to be sold ultimately for final use or consumption	144.030.2(2)
27.	Materials, replacement parts and equipment purchased for use directly upon, and for the repair and maintenance or manufacture of, motor vehicles, watercraft, railroad rolling stock or aircraft engaged as ***common carriers*** of persons or property	144.030.2(3)
28.	***Replacement machinery, equipment and parts*** and the materials solely required for the installation or construction of such replacement machinery, equipment, and parts, used directly in manufacturing, mining, fabricating or producing a product which is intended to be sold ultimately for final use or consumption	144.030.2(4)
29.	Machinery and equipment and the materials and supplies required solely for the operation, installation or construction of such machinery and equipment, purchased and used to establish new, or to replace or expand existing, ***material recovery processing plants*** in this state.	144.030.2(4)
30.	Machinery and equipment, and parts and the materials and supplies solely required for the installation or construction of such machinery and equipment, purchased and used to establish new or to ***expand existing manufacturing, mining or fabricating plants*** in the state if such machinery and equipment is used directly in manufacturing, mining or	144.030.2(5)

	fabricating a product which is intended to be sold ultimately for final use or consumption	
31.	Tangible personal property which is used exclusively in the manufacturing, processing, modification or assembling or ***products sold to the United States government*** or to any agency of the United States government	144.030.2(6)
32.	***Animals or poultry*** used for breeding or feeding purposes	144.030.2(7)
33.	Newsprint, ink, computers, photosensitive paper and film, toner, printing plates and other machinery, equipment, replacement parts and supplies ***used in producing newspapers*** published for dissemination of news to the general public	144.030.2(8)
34.	Rentals of films, records or any types of sound or picture transcriptions for ***public commercial display***	144.030.2(9)
35.	Pumping machinery and equipment used to propel products delivered by ***pipelines*** engaged as common carriers	144.030.2(10)
36.	***Railroad rolling stock*** for use in transporting persons or property in interstate commerce	144.030.2(11)
37.	***Motor vehicles*** licensed for a gross weight of 24,000 pounds or more ***or trailers used by common carriers***, as defined in section 390.020, RSMo, solely in the transportation of persons or property in interstate commerce	144.030.2(11)
38.	***Electrical energy*** used in the actual primary manufacture, processing, compounding, mining or producing of a product, or electrical energy used in the actual secondary processing or fabricating of the product, or a material recovery processing plant, if the total cost of electrical energy so used exceeds ten percent of the total cost of production, either primary or secondary, exclusive of the cost of electrical energy so used or if the raw materials used in such processing contain at least twenty-five percent recovered materials as defined in section 260.200	144.030.2(12)
39.	***Anodes*** which are used or consumed in manufacturing, processing, compounding, mining, producing or fabricating and which have a useful life of less than one year	144.030.2(13)
40.	Machinery, equipment, appliances and devices purchased or leased and used solely for the purpose of preventing, abating or monitoring ***air pollution***, and materials and supplies solely required for the installation, construction or reconstruction of such machinery, equipment, appliances and devices, and so certified by the director of the department of natural resources	144.030.2(14)
41.	Machinery, equipment, appliances and devices purchased or leased and used solely for the purpose of preventing, abating or monitoring ***water pollution***, and materials and supplies solely required for the installation, construction or reconstruction of such machinery, equipment, appliances and devices, and so certified by the director of the department of natural resources	144.030.2(15)
42.	Tangible personal property purchased by a ***rural water district***	144.030.2(16)
43.	Amounts paid or charged for admission or participation or	144.030.2(17)

	other fees paid by or other charges to individuals in or for any place of amusement, entertainment or recreations, games and athletic events, including ***museums, fairs, zoos and planetariums, owned or operated by a municipality or other political subdivision*** where all the proceeds derived therefrom benefit the municipality or other political subdivision and do not inure to any private person, firm, or corporation	
44.	All sales of ***insulin***	144.030.2(18)
45.	***Prosthetic or orthopedic devices*** as defined on January 1, 1980, by the federal Medicare program pursuant to Title XVIII of the Social Security Act of 1965, including the items specified in Section 1862(a)(12) of that act, and also specifically including hearing aids and hearing aid supplies	144.030.2(18)
46.	***Drugs*** which may be legally dispensed by a licensed pharmacist only upon a lawful ***prescription*** of a practitioner licensed to administer those items, including samples and materials used to manufacture samples which may be dispensed by a practitioner authorized to dispense such samples	144.030.2(18)
47.	***Medical oxygen***, home respiratory equipment and accessories	144.030.2(18)
48.	***Hospital beds*** and accessories	144.030.2(18)
49.	***Ambulatory aids***, manual and powered wheelchairs, and stairway lifts	144.030.2(18)
50.	***Braille writers*** and electronic Braille equipment	144.030.2(18)
51.	If purchased by or on behalf of a person with one or more physical or mental disabilities to enable them to function more independently, all sales of ***scooters, reading machines, electronic print enlargers and magnifiers***	144.030.2(18)
52.	Electronic alternative and augmentative ***communication devices***	144.030.2(18)
53.	Items used solely to ***modify motor vehicles*** to permit the use of such motor vehicles by individuals with disabilities	144.030.2(18)
54.	Sales of over-the-counter or ***nonprescription drugs to individuals with disabilities***	144.030.2(18)
55.	Sales made by or to ***religious and charitable organizations*** and institutions in their religious, charitable or educational functions and activities	144.030.2(19)
56.	Sales made by or to all ***elementary and secondary schools*** operated at public expense in their educational functions and activities	144.030.2(19)
57.	Sales of ***aircraft*** to common carriers for storage or for use in interstate commerce	144.030.2(20)
58.	Sales made by or to not-for-profit ***civic, social, service or fraternal organizations***, including fraternal organizations which have been declared tax exempt organizations pursuant to Section 501(c)(8) or (10) of the 1986 Internal Revenue Code, as amended, in their civic or charitable functions and activities	144.030.2(20)
59.	Sales made to eleemosynary and ***penal institutions*** and industries of the state	144.030.2(20)

60.	Sales made to any ***private not-for-profit institution of higher education*** not otherwise excluded pursuant to subdivision (19) of Section 144.030.2 or any institution of higher education supported by public funds	144.030.2(20)
61.	Sales made to a ***state relief agency*** in the exercise of relief functions and activities	144.030.2(20)
62.	***Ticket sales made by benevolent, scientific and educational associations*** which are formed to foster, encourage, and promote progress and improvement in the science of agriculture and in the raising and breeding of animals	144.030.2(21)
63.	***Ticket sales by nonprofit summer theater organizations*** if such organizations are exempt from federal tax pursuant to the provisions of the Internal Revenue Code	144.030.2(21)
64.	***Admission charges and entry fees to the Missouri state fair*** or any fair conducted by a county agricultural and mechanical society organized and operated pursuant to sections 262.290 to 262.530, RSMo	144.030.2(21)
65.	Sales made to any ***private not-for-profit elementary or secondary school***	144.030.2(22)
66.	***Feed additives, medications or vaccines*** administered to livestock or poultry in the production of food or fiber. See #4 above for the definition of "livestock."	144.030.2(22)
67.	***Pesticides*** used in the production of crops, livestock or poultry for food or fiber including adjuvants such as crop oils, surfactants, wetting agents and other assorted pesticide carriers used to improve or enhance the effect of a pesticide and the foam used to mark the application of pesticides and herbicides for the production of crops, livestock or poultry	144.030.2(22)
68.	***Bedding*** used in the production of livestock or poultry	144.030.2(22)
69.	***Natural gas*** used in the primary manufacture or processing of fuel ethanol	144.030.2(22)
70.	***Natural gas, propane, and electricity*** used by an eligible new generation cooperative or an eligible new generation processing entity as defined in section 348.432, RSMo	144.030.2(22)
71.	**Propane or natural gas, electricity or diesel fuel used exclusively for drying agricultural crops** for food or fiber	144.030.2(22)
72.	New or used farm tractors and such other new or used ***farm machinery and equipment*** (other than airplanes, motor vehicles and trailers) and repair or replacement parts thereon and supplies and lubricants used exclusively for such farm machinery and equipment, and supplies and lubricants used exclusively, solely, and directly for producing crops, raising and feeding livestock, fish, poultry, pheasants, chukar, quail, or for producing milk for ultimate sale at retail, including field drain tile and one-half of each purchaser's purchase of diesel fuel therefore which is:	144.030.2(22)

	(a) Used exclusively for agricultural purposes; (b) Used on land owned or leased for the purpose of producing farm products; and (c) Used directly in producing farm products to be sold ultimately in processed form or otherwise at retail or in producing farm products to be fed to livestock or poultry to be sold ultimately in processed form at retail	
73.	Except for local taxes imposed by cities or counties under section 144.032, all sales of metered water service, electricity, electrical current, natural, artificial or propane gas, wood, coal or home heating oil for ***domestic use*** and in any city not within a county, all sales of metered or unmetered water service for domestic use	144.030.2(23)
74.	***Handicraft items*** made by the seller or the seller's spouse if the seller or the seller's spouse is at least sixty-five years of age, and if the total gross proceeds from such sales do not constitute a majority of the annual gross income of the seller	144.030.2(24)
75.	***Excise taxes***, collected on sales at retail, imposed by Sections 4041, 4061, 4071, 4081, 4091, 4161, 4181, 4251, 4261 and 4271 of Title 26, United States Code.	144.030.2(25)
76.	Fuel consumed or used in the ***operation of ships, barges, or waterborne vessels*** which are used primarily in or for the transportation of property or cargo, or the conveyance of persons for hire, on navigable rivers bordering on or located in part in this state, if such fuel is delivered by the seller to the purchaser's barge, ship, or waterborne vessel while it is afloat upon such river	144.030.2(26)
77.	Sales made to an ***interstate compact agency*** created pursuant to sections 70.370 to 70.430, RSMo, (***Bi-State Development Agency***) or sections 238.010 to 238.100, RSMo, (***Kansas City Area Transportation Authority***) in the exercise of the functions and activities of such agency as provided pursuant to the compact	144.030.2(27)
78.	***Computers, computer software and computer security systems purchased for use by architectural or engineering firms headquartered in this state***. For the purposes of this exemption, "headquartered in this state" means the office for the administrative management of at least four integrated facilities operated by the taxpayer is located in the state of Missouri	144.030.2(28)
79.	***Livestock sales*** when either the seller is engaged in the growing, producing or feeding of such livestock, or the seller is engaged in the business of buying and selling, bartering or leasing of such livestock	144.030.2(29)
80.	***Barges*** which are to be used primarily in the transportation of property or cargo on interstate waterways	144.030.2(30)
81.	Electrical energy or gas, whether natural, artificial or propane, water, or other utilities which are ultimately consumed in connection with the manufacturing of ***cellular***	144.030.2(31)

	glass product or in **any material recovery processing plant**	
82.	***Pesticides or herbicides*** used in the production of crops, aquaculture, livestock or poultry;	144.030.2(32)
83.	Tangible personal property purchased for use or consumption directly or exclusively in the ***research and development of prescription pharmaceuticals*** consumed by humans or animals	144.030.2(33)
84.	***Grain bins*** for storage of grain for resale	144.030.2(34)
85.	Feed which are developed for and used in the ***feeding of pets owned by a commercial breeder*** when such sales are made to a commercial breeder, as defined in section 273.325, RSMo, and licensed pursuant to sections 273.325 to 273.357, RSMo	144.030.2(35)
86.	Purchases by a ***contractor on behalf of an entity located in another state***, provided that the entity is authorized to issue a certificate of exemption for purchases to a contractor under the provisions of that state's laws.	144.030.2(36)
87.	Materials purchased by a ***contractor*** for the purpose of fabricating tangible personal property which is used in fulfilling a contract for the purpose of constructing, repairing or remodeling facilities for the following: (a) An exempt entity located in this state, if the entity is one of those entities able to issue project exemption certificates in accordance with the provisions of section 144.062; or (b) An exempt entity located outside the state if the exempt entity is authorized to issue an exemption certificate to contractors in accordance with the provisions of that state's law and the applicable provisions of this section	144.030.2(36)
88.	Tangible personal property purchased for use or consumption directly or exclusively in research or experimentation activities performed by ***life science companies*** and so certified as such by the director of the department of economic development or the director's designees; except that, the total amount of exemptions certified pursuant to this section shall not exceed one million three hundred thousand dollars in state and local taxes per fiscal year. For purposes of this exemption, the term "life science companies" means companies whose primary research activities are in agriculture, pharmaceuticals, biomedical or food ingredients, and whose North American Industry Classification System (NAICS) Codes fall under industry 541710 (biotech research or development laboratories), 621511 (medical laboratories) or 541940 (veterinary services). The exemption provided by this subdivision shall expire on June 30, 2003	144.030.2(37)
89.	All sales or other transfers of tangible personal property to a lessor, who leases the property under a lease of one year or longer executed or in effect at the time of the sale or	144.030.2(38)

	other transfer, to an **interstate compact agency**	
90.	***Sales of tickets to any collegiate athletic championship*** event that is held in a facility owned or operated by a governmental authority or commission, a quasi-governmental agency, a state university or college or by the state or any political subdivision thereof, including a municipality, and that is played on a neutral site and may reasonably be played at a site located outside the state of Missouri.	144.030.2(39)
91.	Electrical energy or gas, whether natural, artificial, or propane, which is ultimately consumed in connection with basic ***steelmaking*** in Missouri and the processing and fabricating thereof by the same steelmaker at such maker's integrated plant.	144.036
92.	Sales at retail made through the use of ***federal food stamp coupons***	144.037
93.	Sales at retail for which federal government coupons or vouchers under the supplemental feeding for ***women, infants and children program*** are used as payment	144.038
94.	Purchases of all tangible personal property made by, or on behalf of, a ***state senator or state representative*** if such purchases are made from funds in such state senator's or state representative's state expense account	144.039
95.	Charges for admissions, as defined in section 144.010, to any of the games of the ***1994 World Cup Soccer Tournament*** which are held in any county of the first classification having a charter form of government which contains all or any part of a city with a population of at least three hundred fifty thousand inhabitants	144.041
96.	New ***light aircraft, light aircraft kits***, parts or components manufactured or substantially completed within this state, when such new light aircraft, light aircraft kits, parts or components are sold by the manufacturer to a purchaser who is nonresident of this state, who will transport the light aircraft, light aircraft kit, parts or components outside this state within ten days after the date of purchase, and who will register any light aircraft so purchased in another state or country	144.043
97.	Forty percent of the purchase price of a ***new manufactured home***	144.044
98.	***Court transcripts, depositions,*** compressed transcripts, exhibits, computer disks containing any such item, and all copies of any such item, which are prepared by a court reporter	144.045
99.	Separately measured ***electrical current to manufacturers of batteries*** in this state for conversion to stored chemical energy in new lead-acid storage batteries solely for the purpose of providing an initial charge in such batteries during the manufacturing process but not for the purpose of recharging any previously manufactured batteries	144.046

100.	***Aircraft*** used solely for aerial application of agricultural chemicals	144.047
101.	***Nondomestic game birds*** sold for the purpose of sport hunting prior to January 1, 1995	144.048
102.	***Clothing, school supplies, computer software and personal computers or computer peripheral devices*** during a three-day period beginning at 12:01 a.m. on the first Friday in August. Certain dollar limits apply. **(Sales Tax Holiday)**	144.049
103.	Tangible personal property and materials for the purpose of ***constructing, repairing or remodeling facilities*** for: (1) a county, other political subdivision or instrumentality thereof exempt from taxation under subdivision (10) of section 39 of article III of the Constitution of Missouri; or (2) an organization sales to which are exempt from taxation under the provisions of subdivision (19) of subsection 2 of section 144.030; or (3) any institution of higher education supported by public funds or any private not-for-profit institution of higher education, exempt from taxation under subdivision (20) of subsection 2 of section 144.030; or (4) any private not-for-profit elementary or secondary school exempt from taxation under subdivision (22) of subsection 2 of section 144.030, if the purchases are related to the entities' exempt functions and activities	144.062
104.	Charges for admissions as defined in section 144.010, to any of the events of the ***United States Olympic Festival to be held in 1994*** in the state of Missouri	144.514
105.	***Textbooks***, as defined by section 170.051, RSMo, when such textbook is purchased by a student who possesses proof of current enrollment at any Missouri public or private university, college or other postsecondary institution of higher learning offering a course of study leading to a degree in the liberal arts, humanities or sciences or in a professional, vocational or technical field, provided that the books which are exempt from state sales tax are those required or recommended for a class. This exemption does not apply to any locally imposed sales or use tax.	144.517
106.	Machines or parts for machines used in a commercial, ***coin-operated amusement and vending business*** where sales tax is paid on the gross receipts derived from the use of commercial, coin-operated amusement and vending machines	144.518
107.	Sales of ***aviation jet fuel*** in a given calendar year to common carriers engaged in the interstate air transportation of passengers and cargo, and the storage, use and consumption of such aviation jet fuel by such common carriers, if such common carrier has first paid to the state of Missouri, in accordance with the provisions of this chapter, state sales and use taxes pursuant to the foregoing provisions and applicable to the purchase, storage, use or consumption of such aviation jet fuel in a	144.805

	maximum and aggregate amount of one million five hundred thousand dollars of state sales and use taxes in such calendar year (expires on December 31, 2003)	
108.	The purchase or storage by any common carrier engaged in the ***interstate air transportation*** of persons and cargo of tangible personal property, other than catered food and beverage products purchased for in-flight consumption and aviation jet fuel, within the state of Missouri, which tangible personal property is purchased or stored in the state of Missouri and is subsequently transported out of state by the common carrier and is used by the common carrier in the conduct of its business as a common carrier	144.807
109.	Any new tax or increase in any state or local sales or use tax rate, which tax or increase was not in effect on December 30, 1987, on the sale, storage, use or consumption of ***aviation jet fuel*** at or upon airports within the state of Missouri, which airports are recipients of federal grant funds, have submitted applications for or have been approved for federal grant funds, or which are otherwise eligible to apply for federal grant funds	144.809
110.	Equipment purchased by a federally licensed commercial or public ***broadcast station*** when such equipment purchase is made as a result of federal mandate and the technological change that results	144.811
111.	***Bullion*** and investment coins	144.815
112.	***Telephone surcharges*** imposed to recoup the costs of deaf relay services and distribution programs	209.255
113.	Flexible ***cellulose casings*** manufactured from cotton linters used and consumed directly in the production of meat or poultry food products intended for human consumption (hotdogs), if the manufacturer recycles the casings	260.285
114.	***Boats or vessels documented by the United States Coast Guard*** or other agency of the federal government and operated on the waters of this state that pay the in lieu watercraft tax. The “in lieu” tax imposed is based on the price of the boat (see statute)	306.016
115.	***State or local admission fees*** imposed upon excursion gambling boat operators that are collected from each passenger boarding such excursion gambling boat	313.821
116.	To impose a use or sales tax upon the use, purchase or acquisition of property paid for out of the funds of any county or other political subdivision.	Mo Const Art III, Sec 39, 10
	Other transactions excluded from tax	
117.	The sale of ***intangible personal property and all services not specifically mentioned in Section 144.020***	144.010 and 144.020

	are not subject to tax. This includes the sale of all custom software and all software delivered electronically (e.g. downloaded off the internet). Canned software sold on a tangible medium (e.g. a CD) is considered tangible personal property and is subject to tax.	
118.	The sale of ***real estate, including fixtures,*** is not subject to tax. This includes items that are sold affixed to real estate (e.g. carpeting and other floor coverings). The same items sold without installation are considered tangible personal property and are subject to tax.	144.010 and 144.020
119.	***Sales for resale*** are not subject to tax. The Missouri Supreme Court and the Administrative Hearing Commission have extended this exclusion to items purchased by a business and transferred to its customers in the course of providing a service to the customers (including food and consumables used by hotels, promotional items given away at ballparks, and, most recently, electricity used in hotel rooms).	144.010.1(10)
120.	***Advertising services*** are a service and not the sale of tangible personal property. Sales of advertising by advertising agencies, broadcast stations, standardized outdoor billboards are exempt.	144.034
121.	***Sale of Bingo Supplies*** to duly-licensed organizations conducting bingo games are exempt.	313.085
122.	All ***State Fair Exhibit Entry Fees***	262.250
123.		

Sales Tax Testimony

I. Streamline Sales Tax- Secretary of Revenue, Kansas Joan Wagnon- December 5, 2005

A. Individual systems of each state limit the amount of taxable electronic interstate commerce

B. Kansas passed a streamline sales tax in 2003

1. Kansas required all businesses to implement a destination tax (where the goods go instead of the source of the goods) - 20-25% of businesses had to adapt to the change from origin to destination
2. Kansas moved too quickly
3. Kansas gave Secretary Wagnon the power to waive fees and late charges
4. Fully implemented on December 31, 2004
5. Voluntary for remote sellers- 250 remote sellers signed up for the optional system
6. Large businesses are able to adapt more quickly and have the resources to make the change

C. Certified Service Providers

1. Designed to help small businesses collect sales tax, whether electronic or in a store
2. Kansas negotiates with 4 certified service providers- 2 that deal with large businesses and 2 that deal with all businesses
3. Dealing with a certified service provider provides advantages to the retailer- no responsibility for audits, no liability for collecting taxes
4. Businesses receive compensation for complying with the system

D. Findings

1. There was a 27% increase in on-line sales last year
2. It is necessary to account for the future
3. In rural areas, the streamlined sales tax has limited applicability
4. Shipping is not as big of a problem as originally believed

II. Streamline Sales Tax- Mo Association of Counties, Chuck Surface- December 5, 2005

A. Counties are concerned with two things- allocations to counties during the annual state budget and every month when sales tax revenues come in

B. There is a 30-35% increase yearly on internet purchases

C. Mo Association of Counties urges the committee to proceed with studying the streamline sales tax

III. Associated Industries of Missouri and Taxpayers Research Institute of Missouri, Ray McCarty- December 5, 2005

A. Destination sourcing is the only way to address internet sales

B. From the retailers perspective, enforcement is lax- that is the reason why the Kansas streamlined sales tax is working
C. Certified Service Providers
    1. Entities that insert themselves in the process and actually collect the tax
    2. File returns and take responsibility for all sales tax collections
    3. Missouri needs certified service providers before they proceed with the adoption and implementation of a streamlined sales tax
    4. Handle all forms of sales tax, not just internet sales
D. Problem- there is a lack of knowledge about where people live and what tax rates should be collected
E. The multitude of tax rates complicate the problem
F. The Federal government needs to determine a uniform process for the states so states can collect internet sales tax across state lines- the system will remain voluntary until the federal government acts
G. Businesses must weigh the cost of compliance and the risk of liability against the benefits of the 2% payment by the state

IV. Sales Tax Exemptions- Department of Revenue, Lowell Pearson- October 24, 2005

A. Section 144 of RSMo imposes tax on tangible personal property and specific designated services
B. 90% of lettering issued by DOR is regarding the sales tax
C. Having a complicated sales tax system such as Missouri's brings about litigation
D. A sales tax on tangible personal property lags behind the country

V. Local Sales Tax- Mike Swoboda, Kirkwood Mayor, Pat Kelly, Brentwood Mayor, and Tim Fischesser, St. Louis Municipal League- October 24, 2005

A. In the 1970s, sales tax initiatives came on ballot for local governments
B. Local governments would trade property taxes for sales taxes
C. In the 1990s, St. Louis County was granted additional sales tax authority by the state
D. Of the 7.3 cent sales tax levied in Kirkwood, 1.25 cents goes to Kirkwood city utility tax
E. Police, Fire, and Emergency services is what the sales tax should be used for
F. The General Assembly should allow for a half cent sales tax for municipalities, or maybe a half cent sales tax increase for fire districts in order to pay for police services
G. The inner parts of St. Louis County are struggling to provide these emergency services, while the outline of the county, the area experiencing growth has the sales tax revenue from new development and large appliance sales to keep revenues up

VI. Sales Tax on Energy- Bayer Crop Science, Jim Gray- December 5, 2005

A. The cost structure of each facility- energy availability and cost has been a key decision point. The exploding cost of energy used in manufacturing has made the taxes on that input more of a competitive challenge.

B. Other states provide for energy use in manufacturing to be exempt from sales and use taxes and this places an unfair competitive burden on our facilities in Missouri.

C. The crop protection products we develop are used by farmers to produce food, feed, and fiber. The sales of crop protection products are tax exempt. We feel that it is not appropriate to tax inputs used to make a product that is tax exempt.

Streamlined Sales Tax Project

Executive Summary

January 2005

The Streamlined Sales Tax Project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The Project's proposals include tax law simplifications, more efficient administrative procedures, and emerging technologies to substantially reduce the burden of tax collection. The Project's proposals are focused on improving sales and use tax administration systems for both Main Street and remote sellers for all types of commerce.

Forty-two states and the District of Columbia are involved in the Project. Forty-five states and the District of Columbia impose a sales and use tax.

The Project was organized in March 2000. The Project is conducting its work through a steering committee with co-chairs, and a number of work groups. Project participants are generally state revenue department administrators but there are also representatives of state legislatures and local governments. Businesses — including national retailers, trade associations, manufacturers, direct marketers, telecommunications companies, leasing companies, technology companies, printers, accounting firms, and others — have actively participated in the Project by offering expertise and input, reviewing proposals, suggesting language, and testifying at public hearings.

The goal of the Streamlined Sales Tax Project is to provide states with a Streamlined Sales Tax System that includes the following key features:

- **Uniform definitions within tax laws.** Legislatures still choose what is taxable or exempt in their state. However, participating states will agree to use the common definitions for key items in the tax base and will not deviate from these definitions. As states move from their current definitions to the Project's definitions, a certain amount of impact on state revenues is inevitable. However, it is the intent of the Project to provide states with the ability to closely mirror their existing tax bases through common definitions.

- **Rate simplification.** States will be allowed one state rate and a second state rate in limited circumstances (food and drugs). Each local jurisdiction will be allowed one local rate. A state or local government may not choose to tax telecommunications services, for example, at one rate and all other items of tangible personal property or taxable services at another rate. State and local governments will accept responsibility for notice of rate and boundary

changes at restricted times. States will provide an on-line rate/jurisdiction database to simplify rate determinations.

- **State level tax administration of all state and local sales and use taxes.** Businesses will no longer file tax returns with each local government within which it conducts business in a state. Each state will provide a central point of administration for all state and local sales and use taxes and the distribution of the local taxes to the local governments. A state and its local governments will use common tax bases.

- **Uniform sourcing rules.** The states will have uniform and simple rules for how they will source transactions to state and local governments. The uniform rules will be destination/delivery based and uniform for tangible personal property, digital property, and services. Special sourcing rules will be developed for unique industries.

- **Simplified exemption administration for use- and entity-based exemptions.** Sellers are relieved of the "good faith" requirements that exist in current law and will not be liable for uncollected tax. Purchasers will be responsible for paying the tax, interest and penalties for claiming incorrect exemptions. States will have a uniform exemption certificate in paper and electronic form.

- **Uniform audit procedures.** Sellers who participate in one of the certified Streamlined Sales Tax System technology models will either not be audited or will have limited scope audits, depending on the technology model used. The states may conduct joint audits of large multi-state businesses.

- **State funding of the system.** To reduce the financial burdens on sellers, states will assume responsibility for funding some of the technology models. The states are also participating in a joint business – government study of the costs of collection on sellers.

The Project proposes that states change their sales and use tax laws to conform with the simplifications as proposed by the Project. Thus, the simplifications would apply to all sellers. Sellers who do not have a physical presence or "nexus" are not required to collect sales and use taxes unless Congress chooses to require collection from all sellers for all types of commerce. Sellers without a physical presence can volunteer to collect under the proposed simplifications. Registration by sellers to voluntarily collect sales and use taxes will not infer that the business must pay business activity taxes, such as the corporate franchise or income tax.

The Streamlined Sales Tax System will provide sellers the opportunity to use one of three technology models. A seller may use Model 1 where a Certified Service Provider, compensated by the states, will perform all of the seller's sales tax

functions. A seller may use Model 2, a Certified Automated System, to perform only the tax calculation function. A larger seller with nationwide sales that has developed its own proprietary sales tax software may use Model 3 and have its own system certified by the states collectively. However, some sellers may choose to continue to use their current systems and still enjoy the benefits of the Project's simplifications.

The Streamlined Sales Tax Project envisions two components to the legislation necessary to accomplish the Project's goals. First, states would adopt enabling legislation referred to as the Uniform Sales and Use Tax Administration Act ("Act"). The Act allows the state to enter into an agreement with one or more states to simplify and modernize sales and use tax administration in order to reduce the burden of tax compliance for all sellers and all types of commerce. The Act does not require any amendments to a state's sales and use tax law.

Secondly, states would amend or modify their sales and use tax laws to achieve the simplifications and uniformity required by the participating states working together. The Project refers to this legislation as the Streamlined Sales and Use Tax Agreement ("Agreement"). Some states will require only minor changes to current law to implement the requirements of the Agreement. Other states with more complicated sales tax laws may require significant changes to current law to be in accord with the Agreement.

A certificate of compliance will document each state's compliance with the provisions of the Agreement and cite applicable statutes, rules or regulations, or other authorities supporting such compliance. Public notice and comment will be provided before a state becomes part of the interstate Agreement. A state is in compliance with the Agreement if the effect of the state's laws, rules or regulations, and policies is substantially compliant with each of the requirements of the Agreement. If a state is found to be out of compliance with the Agreement, it will not be accepted into the interstate Agreement or will be sanctioned or expelled by the other participating states. In a voluntary system, sellers who are voluntarily collecting sales taxes for participating states may decide to no longer collect for the expelled state. Also, that state may not have a vote on changes in the Agreement.

A governing board will be comprised of representatives of each member state of the Agreement. Each member state is entitled to one vote on the governing board. The governing board is responsible for interpretations of the Agreement, amendments to the Agreement, and issue resolution. A State and Local Government Advisory Council and a Business and Taxpayer Advisory Council from the private sector will advise the governing board.

On November 12, 2002, thirty states and the District of Columbia approved the interstate Agreement provisions. As of January 2005, twenty-one states have moved forward and enacted all or part of the conforming legislation.

It’s anticipated that states that enacted the conforming legislation and are found to be in compliance with the Agreement will continue as the governing states of the interstate Agreement of the future. States will verify compliance with the requirements of the Agreement in early 2005.

The project website is www.streamlinedsalestax.org.

Claire McCaskill

Missouri State Auditor

March 2006

Transportation Development Districts

Report No. 2006-12

auditor.mo.gov

Office Of The
State Auditor Of Missouri
Claire McCaskill

March 2006

YELLOW SHEET

The following problems were included in our audit of Transportation Development Districts.

Transportation development districts (TDDs) are separate political subdivisions established and organized for the construction of roads, bridges, interchanges, or other transportation-related projects, financed through the issuance of notes, bonds, or other debt securities and governed by a board of directors. These boards have the authority to impose sales taxes or tolls, or levy property taxes or special assessments within the boundaries of the respective TDDs to pay those transportation-related project expenditures.

TDDs are initiated by the filing of a petition in the circuit court of the county where the proposed district is located. For TDDs established as of December 31, 2004, 96 percent of the petitions initiating their establishment were filed by the owners of the property located within the proposed district. In many instances, it appears only a single property owner/developer petitioned for the creation of a district.

Although the Transportation Development District Act was enacted in 1990, the first TDD was not established until 1997, apparently the result of statutory changes the General Assembly made that year. These changes have resulted in a dramatic increase in the number of TDDs established. As of December 31, 2004, 69 TDDs had been established in the state. This significant growth has continued in 2005, with 18 additional TDDs being established as of October 2005.

In a survey of the 69 districts, officials of 68 of the TDDs reported total estimated transportation project costs of over $578 million. In addition, 62 of the 69 TDDs reported total estimated revenues of over $787 million would be collected during the lives of the respective TDDs. All of the districts established as of December 31, 2004, have imposed a sales tax, with rates ranging from one-eighth of one percent to one percent on retail items sold within the districts' boundaries. As a result, all retail establishments located within a TDD charge a higher total sales tax than the retail establishments that lie outside the district's boundaries.

Our audit disclosed various issues regarding the TDDs in the areas of public awareness/involvement, and accountability and compliance, including:

- There is no requirement for the public to be notified when a property owner(s)/developer files a petition with the circuit court to form a TDD. In addition, public hearings regarding the establishment of TDDs are not required to be held.

- Neither registered voters nor their elected representatives are involved in the decision to levy

taxes for most TDDs.

- There is no requirement the petitions filed with the circuit court include any information regarding estimated transportation project costs or the anticipated revenues that will be collected over the life of the TDD.

- There is no requirement for an independent review or oversight of TDD transportation project costs or other expenditures.

- There is disagreement over whether the construction of a TDD-funded transportation project(s) can be started prior to the legal establishment of the applicable TDD.

- Most TDD sales taxes are not collected by the Missouri Department of Revenue, creating less assurance over the controls and monitoring of such revenue.

- Many TDDs had not filed annual financial reports with the State Auditor's Office (SAO), as required, and the current audit requirements related to TDDs need to be reconsidered.

- In many cases, significant project costs were initially paid by the private developer(s), who were then subsequently reimbursed by the TDD after bonds or other debt had been issued. Such reimbursement process weakens the accountability over project-related costs.

- The revenues of TDDs located in TIF areas are being handled in different manners, and in some instances there is not adequate assurance TDD sales tax revenues are only used to pay the TDD's share of bond financing costs.

The audit recommended the General Assembly review the issues addressed in the report and work with the Missouri Department of Transportation, the State Auditor's Office, and other governmental entities to make necessary revisions to the TDD-related statutes.

All reports are available on our website: www.auditor.mo.gov

TRANSPORTATION DEVELOPMENT DISTRICTS

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STATE AUDITOR'S REPORT

CLAIRE C. McCASKILL
Missouri State Auditor

Honorable Matt Blunt, Governor
and
Members of the General Assembly

We have audited the transportation development districts (TDDs) established in the state of Missouri. This audit was conducted relative to our responsibilities pursuant to Section 238.272, RSMo. The scope of this audit included, but was not necessarily limited to, those TDDs established since the inception of the Transportation Development District Act in 1990 through December 31, 2004. The objectives of this audit were to:

1. Identify the various TDDs that have been established and report selected information regarding those entities.

2. Determine the extent of the TDDs' estimated transportation projects costs as well as the total revenues those entities expect to collect, as reported by the individual TDDs.

3. Identify and report various issues related to public awareness/involvement, accountability, and compliance involving TDDs.

4. Perform a more in-depth review of selected TDDs that have operated for at least 3 fiscal years.

Our methodology to accomplish these objectives included reviewing financial reports or audits filed with the State Auditor's Office, information maintained by the Missouri Department of Transportation (MoDOT), and information obtained from various TDD officials/representatives and municipal officials.

Our audit was conducted in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such procedures as we considered necessary in the circumstances.

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The following Objectives, Scope, and Methodology and Observations and Results sections present our comments, observations, and results regarding our audit of transportation development districts.

Claire McCaskill
State Auditor

September 16, 2005 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	Thomas J. Kremer, CPA
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OBJECTIVES, SCOPE, AND METHODOLOGY

TRANSPORTATION DEVELOPMENT DISTRICTS
OBJECTIVES, SCOPE, AND METHODOLOGY

Sections 238.200 to 238.275, RSMo, allow for the formation of transportation development districts (TDDs). These entities are separate political subdivisions established and organized for the construction of roads, bridges, interchanges, or other transportation-related projects. The projects are generally financed by these districts through the issuance of notes, bonds, or other debt securities for a period not to exceed forty years. A TDD is governed by a board of directors of not less than five nor more than fifteen members. The boards have the authority (after qualified voter approval[1]) to impose sales taxes or tolls, or levy property taxes or special assessments within the boundaries of the TDD to pay the expenditures of the entity, including the liquidation of debt incurred to fund the transportation-related projects. The revenues of a TDD, most frequently sales taxes, can only be used for transportation-related projects.

The process of establishing a TDD is initiated by the filing of a petition in the circuit court of the county where the proposed district is located. Such a petition can be filed by: (1) not less than 50 registered voters residing within the proposed TDD; (2) if there are no eligible registered voters residing within the proposed district, by all the owners of real property located within its proposed boundaries; (3) a local transportation authority; or (4) two or more local transportation authorities. A local transportation authority includes a county, city, special road district, or any other local public authority having jurisdiction over transportation projects and services.

For those TDDs established as of December 31, 2004, most of the petitions initiating their establishment were filed by the owners of the property located within the proposed district. There is no minimum number of property owners that can petition for the formation a TDD, and in many instances it appears there has been a single property owner/developer who has petitioned for the creation of a district. See Appendix A for a complete list of all TDDs established as of December 31, 2004, which includes information regarding their establishment.

Within 30 days after the petition is filed, the circuit clerk is required to provide a copy of it to the respondents, who must include the Missouri Highways and Transportation Commission (highway commission) and each affected local transportation authority. The respondents then have 30 days to file an answer stating agreement with or opposition to the creation of the district. In addition, any resident, taxpayer, or any other entity within the proposed district may join in or file a petition supporting or answer opposing the creation of the district and seeking a declaratory judgment.

The court then hears the case without a jury and enters a declaratory judgment. If the circuit court determines the petition satisfies legal requirements, the court enters its judgment to that effect. If the petition is filed by registered voters or by a local transportation authority(ies), the court certifies the questions regarding the district's creation, project development, and proposed funding for public notice and voter approval. A public hearing may be held prior to the election. If the petition is filed by the owners of the real property located within the proposed district, the

[1] Section 238.202, RSMo, defines qualified voters as any persons eligible to be registered voters who reside within the proposed district. However, if no registered voters reside within the proposed district, the owners of real property located within the proposed district constitute the qualified voters.

court shall declare the district organized and certify the funding methods stated in the petition for qualified voter approval. If there is no opposition to its creation, the court can make such certifications without a court hearing.

The district must submit the proposed projects with specifications, to the highway commission for its approval. If the proposed projects are not intended to be merged into the state highway system, the district must also submit the proposed projects with specifications to the applicable local transportation authority for its approval since that entity will subsequently be responsible for accepting ownership and responsibility for the projects and related infrastructure.

Section 238.262, RSMo, authorizes the highway commission to adopt administrative rules related to TDDs. Pursuant to this statute, the Missouri Department of Transportation (MoDOT) has prepared administrative guidelines which, while not promulgated as administrative rules, are recommended practices which apply to any TDD whose projects are partially or wholly constructed on or to be merged into the state highway system. If the proposed transportation projects are not on the state highway system there is no statute that authorizes the local transportation authorities to establish administrative rules for the TDD projects.

Once a TDD has been formed, MoDOT has generally limited its role to the issuance of permits, review of design plans, and inspection of projects constructed on state right-of-way or connecting to the state highway system. MoDOT's involvement in these instances has not involved financial oversight. According to information provided by MoDOT, of the 69 TDDs established at December 31, 2004, 43 of those districts (or 62%) had projects of this nature. In a few cases, MoDOT has assisted with the financing and construction of the improvements because the applicable TDD accelerated a project MoDOT had already planned to construct. In those instances, MoDOT indicated it exercised a much higher degree of oversight over the financing and construction of those projects, including financial oversight. Six of the 69 TDDs (or 9%) established included projects of this nature. For the 20 remaining TDDs (or 29%), MoDOT had no participation or oversight over the projects because they were not constructed on state right-of-way or connected to the state highway system. In those instances, the local transportation authorities (the city or county) were responsible for overseeing the projects.

Many TDDs are located within a tax increment financing redevelopment (TIF) area. Tax increment financing is authorized pursuant to Section 99.800 to 99.865, RSMo, and allows a municipality (a city or county) to approve TIF plans and use new tax revenues generated by development to reimburse certain costs related to that development. This economic development tool provides an incentive for the development to occur. The new tax revenues generated for TIF-purposes include property taxes and 50 percent of all local economic activity taxes in the area, including the sales taxes of a TDD.

Section 67.010, RSMo, requires each TDD to prepare an annual budget which represents a complete financial plan for the ensuing fiscal year. In addition, Section 105.145, RSMo, requires each district to file an annual financial report with the State Auditor's Office (SAO).

Although there is no statutory annual audit requirement, many districts have issued bonds and are required to obtain annual audits by the bond covenants or bond underwriter. In addition,

Section 238.272, RSMo, provides the SAO shall audit each TDD once every three years, and may audit more frequently if deemed appropriate. The cost of the audit is to be paid by the respective district.

A TDD must transfer ownership of the transportation projects to the highway commission or the local transportation authority within six months after completion of the project and initial maintenance costs have been paid. The highway commission or local transportation authority will assume ownership and responsibility for any future maintenance costs of the transportation projects.

Section 238.275, RSMo, provides for the abolishment of a TDD once its projects are completed, ownership of the projects has been transferred to the highway commission or the local transportation authority, and the district has no outstanding liabilities. In addition, a TDD can be abolished if the board of directors determines the projects cannot be completed due to lack of funding or for any other reason. The board of directors must submit the question to abolish the district to a vote of the registered voters or all of the property owners in the TDD, if there are no registered voters. In addition, prior to submitting the question to abolish the district to the applicable voters, the SAO must audit the TDD to determine its financial status, and whether it can be abolished. As of September 2005, the SAO had not been advised of any action(s) regarding the abolishment of a TDD.

Objectives

The objectives of this audit were to 1) identify the various TDDs that have been established and report selected information regarding those entities; 2) determine the extent of these districts' estimated transportation project costs, as well as the total revenues those entities expect to collect, as reported by the individual TDDs; 3) identify and report various issues related to public awareness/involvement, accountability, and compliance involving TDDs; and 4) perform a more in-depth review of selected TDDs that have operated for at least 3 fiscal years.

Scope

The scope of this audit included, but was not necessarily limited to, those TDDs established since the inception of the Transportation Development District Act in 1990 through December 31, 2004. At December 31, 2004, there were 69 TDDs which had been established in the state of Missouri, with one of these districts currently under appeal by the city of Chesterfield, in St. Louis County. Sixteen TDDs had operated for at least three complete fiscal years as of December 31, 2004.

Information used to compile this report included:

- TDD annual financial reports or audit reports and related information submitted to and maintained by the SAO.

- The provisions of the Transportation Development District Act, which include Sections 238.200 through 238.275, RSMo.

- A TDD database, petitions, court orders, and related information maintained by the Missouri Department of Transportation (MoDOT).

- Completed questionnaires received from officials or representatives of the TDDs which requested information including, but not limited to, estimated project costs, financing obligations, anticipated revenues, and expected life of the respective TDD.

- Communications with, and information received from, various TDD officials/representatives and municipal officials.

Methodology

During our audit, we used annual financial reports or audit reports that had been filed by the various TDDs with the SAO as well as an internal database used by this office to identify those TDDs which had been established and to account for the various financial reports/audits received.

We gathered additional information regarding TDDs through discussions with various MoDOT officials and from a TDD database and files maintained by that agency. Information obtained included TDD name, location, applicable county/municipality, date established, identity of the individual(s)/entity who filed the petition, the type of funding (i.e., sales taxes, property taxes, etc.), and the funding rate (i.e., 1 percent). Some of the information obtained from MoDOT is presented in Appendix A.

Survey questionnaires were sent to each TDD which had been established as of December 31, 2004, requesting information including, but not limited to: estimated total project costs, how project costs were financed and the amount of that financing, estimated total revenues to be collected and over what period of time, when the collection of revenue and incurrence of expenses started, who was responsible for collection of the revenues and the administering of the funds, and whether financial audits have been conducted by a CPA firm. Some of the survey information received from the TDDs is presented in Appendix B. A copy of the survey questionnaire is presented in Appendix D.

To get a better understanding of the operations and activities of TDDs and relative to our audit responsibilities pursuant to Section 238.272, RSMo, we selected sixteen of these districts (the selected districts) for a more in-depth review. The selected districts were those that had operated for at least three complete fiscal years as of December 31, 2004, and would be subject to audit pursuant to state law. We requested and obtained additional information regarding these selected districts through communications with various TDD officials or representatives and municipal officials who have been involved with district activities.

The objectives of this additional review of the selected TDDs were to 1) determine and report information concerning the establishment of the applicable districts and taxes imposed; 2) identify the transportation projects of the district and related costs; 3) determine how the transportation projects were financed; 4) identify various controls and procedures in place regarding the TDD's financial activities, including whether periodic financial audits are

conducted and whether any independent financial oversight exists; and 5) review and report the TDDs' financial data. A Schedule of Receipts, Disbursements, and Cash Balances for the selected districts is presented in Appendix E.

Limitations

Some data presented in Appendixes A, B, and E was compiled from survey information submitted by officials or representatives of the various TDDs and the annual financial or audit reports submitted by those districts. This information was not verified for accuracy by us.

OBSERVATIONS AND RESULTS

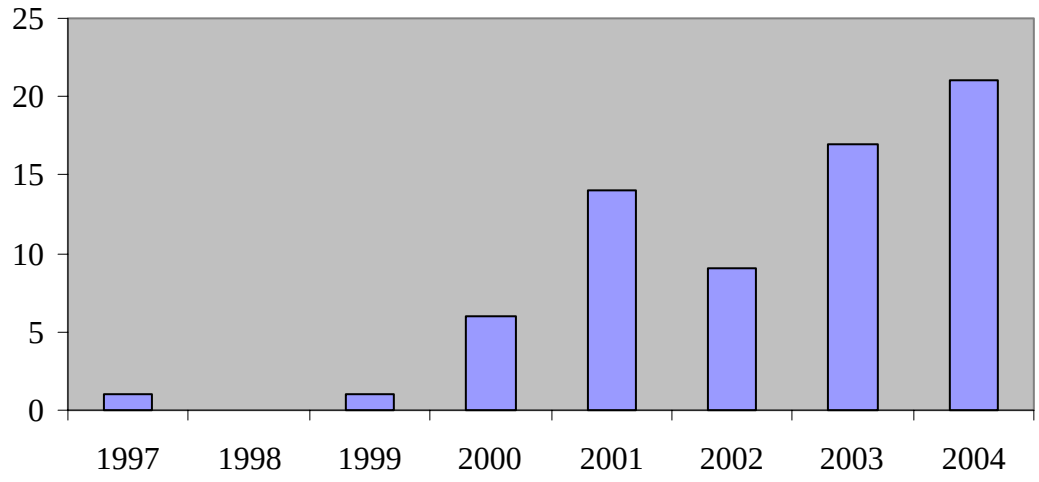
TRANSPORTATION DEVELOPMENT DISTRICTS
OBSERVATIONS AND RESULTS

Background

As of December 31, 2004, 69 transportation development districts (TDDs) had been established in the state of Missouri. Over half of these districts have been established in the state's two biggest metropolitan areas, with 26 and 12 of the TDDs being located in the city of St. Louis or St. Louis County and Jackson County, respectively.

Even though the Transportation Development District Act was enacted in 1990, the first TDD was not established until 1997, apparently the result of statutory changes the General Assembly made that year. In those legislative changes, the General Assembly established another means of creating a TDD, allowing the owners of the real property located within the proposed district to petition for its creation, if there were no registered voters residing within the district. Previously, a petition to establish a TDD could only be filed by not less than 50 registered voters residing within the proposed district or by a local transportation authority.

This statutory change has apparently resulted in a dramatic increase in the number of TDDs established, particularly in recent years, as shown in the following graph.



Number of TDDs Established Each Year

Of the 69 TDDs established as of December 31, 2004, 66 (or 96 percent) were initiated by a petition filed by the property owners. The significant growth in the number of newly-established TDDs has continued in 2005, with 18 additional TDDs being established as of October 2005 (according to MoDOT records).

In a survey of the 69 TDDs established as of December 31, 2004, officials or representatives of 68 of the TDDs reported total estimated transportation project costs of

over $578 million. Estimated transportation project costs of 1 TDD was not provided because the costs were not going to be determined until sales tax revenues were available. In addition, 62 of the 69 TDDs reported total estimated revenues of over $787 million would be collected over the lives of the respective TDDs. Anticipated revenue information for 7 of the districts was not provided because the information had not been determined or could not be located. The total estimated project costs and anticipated revenue amounts provided by the various TDDs are presented in Appendix B. It appears that interest costs on TDD debt and administrative expenses of the districts would account for the difference between total estimated project costs and total anticipated revenues of the various TDDs.

The table below breaks down the total estimated project costs and anticipated revenues of the 69 TDDs into various dollar ranges.

	Number of TDDs	
Dollar Range	Estimated Transportation Project Costs	Expected Revenues
$0 to $1million	10	7
$1 million to $5 million	30	19
$5 million to $10 million	10	13
$10 million to $15 million	10	6
$15 million to $35 million	7	14
More than $35 million	1	3
Not reported	1	7

In our survey, the TDD officials/representatives reported the number of years their respective districts expected to collect revenue (i.e. sales taxes, etc.), which should correlate with the expected life of the districts. Based on this information, the expected life of the 69 TDDs will range from 5 to 40 years. All of the districts established as of December 31, 2004, have imposed a sales tax, with rates ranging from one-eighth of one percent (1/8 percent) to one percent on retail items sold within the districts' boundaries. As a result, all retail establishments located within a TDD charge a higher total sales tax than the retail establishments that lie outside the district's boundaries. For example, if a TDD imposes a 1 percent sales tax and the total sales taxes charged in the surrounding community total 6 percent, retail establishments located within the TDD would charge a total sales tax of 7 percent on purchases, or 17 percent higher than the tax rate on retail purchases made outside the TDD. Also, 6 of the 69 TDDs have imposed a special assessment or property tax in addition to a sales tax.

The boundaries of 33 (48 percent) of the TDDs established as of December 31, 2004, were located either completely or partially in a tax increment financing redevelopment (TIF) area. Pursuant to Section 99.845, RSMo, 50 percent of the additional tax revenues generated in such areas are to be used for the purposes of that particular TIF area. After the TIF portion of the TDD revenues are disbursed to the applicable city for deposit into a TIF account, the remaining portion is to be used by the TDD to fund its transportation

project(s). However, based on our review of the selected districts, we noted three different scenarios occurring related to those TDDs located within a TIF area.

For some TDDs, 50 percent of the TDD tax revenues generated were turned over to the applicable city for TIF purposes (as described above). In other instances, cooperative agreements existed between the applicable city and the TDD which allowed the district to apply most, if not all, of its sale tax revenue to its own transportation project costs. For still other TDDs, we found the districts had agreed to disburse all of their revenues (both the TIF portion and the non-TIF portion), less administrative costs, to the applicable cities to help retire the city's TIF bond debt. In those instances, the applicable cities had used the proceeds from TIF bonds to finance both the TDDs' transportation projects and the cities' redevelopment (TIF) projects.

Identification of Issues

Our audit disclosed various issues regarding the TDDs in the areas of public awareness/involvement, and accountability and compliance which are presented below:

1. LACK OF PUBLIC AWARENESS/INVOLVEMENT

- **There is no requirement for the public to be notified when a property owner(s)/developer files a petition with the circuit court to form a TDD. In addition, public hearings regarding the establishment of TDDs are not required to be held.**

  Current law does not require the circuit clerk to give any notice to the public of a petition filed to create and fund a TDD when the petition is filed by the property owner(s)/developer of a proposed TDD. This situation involves those TDDs in which no registered voters reside within the boundaries and comprised 66 of the 69 (96 percent) TDDs established as of December 31, 2004. For these TDDs, it appears the developer was generally the only property owner or owned much of the property in the district. In addition, there is no statutory provision which requires any public hearings be held prior to the creation of these districts.

  Current law only requires the public be notified (through a notice in the newspaper) in situations where a petition related to a proposed TDD is filed by at least 50 registered voters who reside in the district, a government body, or joint government bodies. In addition, while a public hearing regarding these proposed TDDs may be ordered by the applicable circuit court, a public hearing is not required.

  To provide better public awareness of the establishment of TDDs, notification should be provided to the public (through a notice in the newspaper or some other means) of all petitions filed related to the proposed establishment of a TDD, and public hearings should be held prior to the creation of these districts. For those TDDs that have been established, consideration should be given to ways

citizens/consumers might be made more aware that they are paying additional taxes on purchases made in those districts.

- **Neither registered voters nor their elected representatives are involved in the decision to levy taxes for most TDDs.**

  For those TDDs established pursuant to a petition filed by the property owner(s)/developer, it is the responsibility of the property owner(s) to elect the district's board of directors. This board is responsible for imposing a district sales tax or other revenue method, after receiving approval to do so by the property owners.

  In 96 percent of the TDDs established as of December 31, 2004, such tax impositions have been authorized by a few property owners who own the property within the districts' boundaries. Of the 66 TDDs established pursuant to a petition filed by the property owners, 60 involved 4 or fewer property owners. The taxes approved by these property owners and subsequently imposed by the TDD boards are paid by all citizens who purchase goods or services within the district, and are in addition to state and other local taxes those citizens/consumers are required to pay.

  The imposition of TDD taxes, particularly sales taxes, in the present manner would appear to be inconsistent with the general principle that tax increases are approved by registered voters or their elected representatives.

2. ACCOUNTABILITY AND COMPLIANCE ISSUES

- **The individuals/entities responsible for initiating the establishment of a TDD are not required to include the estimated transportation project(s) costs or anticipated revenues to be collected in their petition to the circuit court.**

  Under current law governing TDDs, there is no requirement the petitions filed with the circuit court include any information regarding estimated transportation project costs or the anticipated revenues that will be collected over the life of the TDD. Therefore, it appears TDDs did not generally include such information with the petitions filed with the circuit courts, nor included in information provided to MoDOT or the local transportation authorities. To obtain this information, we surveyed the various TDDs. Of the 69 districts established, 7 could not provide an estimate of the total revenues they anticipate collecting and 1 district could not provide estimated project costs.

  In addition, we found that 13 of the 61 districts which had reported expected revenues and estimated project costs on our survey questionnaires, identified revenues which appeared to be excessive (more than two times the estimated cost of the transportation projects). Several of these TDDs reported projected revenues that were based on the district's life that had been requested during the

petition process and not what was actually determined later during the financing stage.

To provide adequate information to the courts, transportation authorities, and the public, the statutes governing the establishment of TDDs should require the petitions initiating the districts to include estimated transportation project costs and the anticipated revenues to be collected over the life of the TDDs. In addition, those entities or individuals petitioning for the creation of a district should take care to ensure such project cost and revenue estimates are reasonable and can be supported.

- **There is no requirement for an independent review or oversight of TDD transportation project costs or other expenditures.**

  For those TDDs established based on a petition of the property owners (66 of 69 TDDs at December 31, 2004), the districts are administered by a board of directors elected by the property owners in the district. For most of these TDDs, the developer is the only property owner or one of only a few property owners. In addition, the elected boards are generally composed of employees or representatives of the property owner(s)/developer. In essence, the property owner(s)/developer can control, oversee, and incur costs associated with public transportation projects that are associated with developments with which they have a personal financial interest. There is no other public vote on the selection of these boards and no statutory requirement of an independent review or oversight of a TDD's expenditures by the applicable transportation authority prior to payment.

  Although no independent review or oversight of TDD expenditures is required, we found that for 9 of the 16 selected districts the applicable transportation authority (the city in most cases) was exercising some type of review or oversight of transportation project and/or administrative costs. In some cases, a city official(s) was required to review and approve all expenditures of the TDD prior to their payment. While not currently required by law, such independent oversight provides additional assurance the TDD expenditures are necessary and proper.

  For 6 of the 16 selected districts, the activities and operations were handled by the TDDs' boards without any apparent independent oversight by the transportation authority or other public entity.

  It was not determined whether any independent oversight existed for 1 selected district as officials of that TDD did not provide information requested regarding any involvement or review of its financial activities by its local transportation authority.

Requiring the transportation project costs and other expenditures of those TDDs initiated by the property owner(s)/developer to be reviewed by the applicable transportation authority prior to payment would provide more accountability and assurance that expenditures are proper and necessary. MoDOT would appear to be the appropriate entity to review the TDD-related costs of projects for which it will subsequently accept full ownership and future maintenance responsibility. The local transportation authorities (i.e. the applicable city, etc.) should be responsible for overseeing the costs of the TDD-related projects they will own and maintain. For those projects which will be partly owned by MoDOT and a local transportation authority, those entities would need to coordinate any financial oversight efforts.

- **It is unclear whether the construction of a TDD-funded transportation project(s) can be started prior to the legal establishment of the applicable TDD.**

  There is currently some disagreement whether the construction of a TDD-funded transportation project can be started prior to the legal establishment of the district. Section 238.225, RSMo, states "before construction or funding of any project, the district shall submit the proposed project, together with the proposed plans and specifications, to the commission for its prior approval of the project." Apparently MoDOT and private legal counsel for some TDDs have different views as to how this statute and other provisions of Chapter 238 should be interpreted.

  MoDOT officials indicated their department's position is that the construction of a TDD-related project cannot be started until the district has been legally established and formally approved by the highway commission (or the local transportation authority, if the project is not on the state highway system). Those officials believe this position is consistent with the legislative intent of the applicable statutes. However, communications with private attorneys of several TDDs found that they do not agree that a TDD must be legally established before the construction of a TDD-funded transportation project is started.

  Information provided by one TDD indicated that a few of its transportation projects were completed prior to the legal establishment of the TDD. In that case, the property owner/developer was subsequently reimbursed approximately $526,700 for these transportation projects after the TDD was established and revenue bonds were issued. A MoDOT official informed us that in another instance a $7.5 million transportation project was almost complete before the property owners/developer filed a petition with the court requesting the formation of the district. We also found that 4 of the 16 selected districts started, and in some cases completed, transportation projects prior to the respective TDDs being legally established.

  It appears the applicable statutes need to be clarified regarding this matter.

- **Unlike most other sales tax revenues collected in the state, very few TDD sales taxes are administered by the Missouri Department of Revenue (DOR). This situation provides less assurance these revenues are properly collected and accounted for and less ability to monitor the level of sales tax distributions to the TDDs.**

  Current statutes do not require the DOR to administer the sales tax revenues of most TDDs that have been established. Sections 238.235 and 238.236, RSMo, provide that any sales taxes imposed by TDDs, except for those districts that consist of an entire county(ies) or city(ies), are to be collected and accounted for by the districts themselves. The DOR is only responsible for administering the sales tax revenues of those TDDs that consist of an entire county(ies) or city(ies). At December 31, 2004, the DOR was not accounting for any sales tax revenues for any TDDs. According to DOR officials, that department did not become responsible for any TDD sales tax revenues until January 2006, when it began administering the sales tax revenues of one TDD.

  It appears that generally the TDDs that have been established have entered into an agreement with a private contractor or the local municipality to account for the sales taxes. Of the 16 selected TDDs reviewed, we noted the accounting of TDD sales tax revenues was evenly split between private contractors and the local municipalities.

  The DOR is responsible for administering the vast majority of sales tax revenues in the state and has established controls and procedures to maximize and safeguard this process. Having DOR handle this function would also allow the sales tax revenues distributed to TDDs to be more effectively monitored by auditors and other outside parties to help ensure the sales tax collections are discontinued at that time when no further collections are needed.

- **Many of the TDDs had not filed annual financial reports with the State Auditor's Office (SAO), as required.**

  As of December 31, 2004, we identified 15 of 69 TDDs (22 percent) that had not filed one or more annual financial reports with the SAO, as statutorily required. Section 105.145, RSMo, requires that all political subdivisions file an annual financial report with the SAO, and 15 CSR 40-3.030 provides that if a political subdivision is audited by a CPA firm, a copy of the audit report can be filed in lieu of a separate financial report. The annual financial report is to be filed within 4 months of the entity's fiscal year-end, but an audit report can be filed within 6 months of the entity's fiscal year-end.

The following table indicates with an "X" the 15 TDDs that had financial activity and did not file a financial report with the SAO by December 31, 2004, for fiscal year 2003 and/or prior.

TDD Name	Date Established	Fiscal Year-End	FY 03	FY 02	FY 01
Ballwin Towne Center	04/26/01	12/31	X	X	X
Boonville Riverfront	02/09/01	12/31		X	X
Country Club Plaza of Kansas City, Missouri	07/12/01	12/31	X	X	X
Douglas Square	09/21/00	12/31			X
Hanley/Eager Road	12/16/02	12/31	X		
I-470 & I-350	03/17/01	12/31	X	X	X
Interstate Plaza/North Town Village	11/06/01	12/31	X		
Kenilworth	08/15/00	12/31	X		
Mark Twain Mall	02/20/01	12/31	X	X	
Platte County Missouri South I	06/19/01	12/31	X	X	X
Platte County Missouri South II	04/12/02	12/31	X	X	
Raintree North	08/19/02	12/31	X		
Shoppes at Cross Keys	09/18/02	12/31	X		
Shoppes at Old Webster	11/29/01	12/31	X		
Stardust-Munger-Diamond	10/16/01	12/31	X		

The TDDs noted in the above table were contacted during our review and they provided the applicable financial reports upon our request. There were 10 other TDDs that had not filed a report(s) for some period(s) because no financial activity had occurred. In such situations, a TDD should notify the SAO indicating it had no financial activity.

As of October 2005, 35 TDDs established as of December 31, 2004, had not filed annual financial reports/audits for fiscal year 2004. Of these districts, 18 were established in 2004. The remaining 17 TDDs represented districts established prior to 2004. Many, but not all, of the TDDs listed in the above chart were among those TDDs which had not yet filed reports/audits for 2004. TDDs should make every effort to ensure the required annual financial reports/audits are filed by the time frames specified in 15 CSR 40-3.030.

The state regulation also provides that an audit report submitted to satisfy the financial reporting requirements of Section 105.145, RSMo, should be prepared in conformity with generally accepted government auditing standards (GAGAS). During our review of the selected districts, it was noted that of 8 districts which had received independent financial audits, 3 of the audits were conducted in accordance with generally accepted auditing standards rather than GAGAS. To fully comply with 15 CSR 40-3.030 reporting requirements, financial audits submitted in lieu of annual financial reports should be conducted in accordance with GAGAS.

- **The SAO is not notified when a TDD is established. In addition, current audit requirements related to TDDs need to be reconsidered.**

  Section 238.272, RSMo, requires the SAO to audit each TDD at least every three years, and more frequently if deemed necessary. In addition, Section 238.275.3, RSMo, requires the SAO to audit a TDD prior to a vote regarding its abolishment. As indicated above, Section 105.145, RSMo, requires all political subdivisions in the state to file an annual financial report with the SAO. Despite these statutory responsibilities given the SAO regarding TDDs, there is no statutory provision requiring the SAO to be notified when a TDD is established. Although contacted by some TDD representatives after a district was established, it was necessary for us to consult with MoDOT officials to identify many of the TDDs which had been established.

  In addition, while not statutorily required many TDDs are already being audited by independent auditors, with 19 of 56 (34 percent) TDDs indicating a financial audit was conducted for fiscal year 2004 by an independent auditor. It appears many of these audits are required by bond or other debt service covenants. Requiring such independent audits subject to rules and regulations promulgated by the SAO, would help avoid any duplication of audit work and related costs, while maintaining some SAO involvement in the post audit process of these districts.

- **Payment of project-related costs by the developer complicates the audit process and weakens accountability over those costs.**

  The manner in which the project design, engineering and construction costs were sometimes initially financed created difficulties in ensuring costs were adequately reviewed by independent audits. It appears that in many cases, significant project costs were initially paid by the private developer(s), who were then subsequently reimbursed by the TDD after bonds or other debt had been issued. In 10 of the 16 selected districts reviewed, the developer(s) initially paid some, if not all, of the project costs and were later reimbursed by the TDD for the costs incurred from debt proceeds. Some of these reimbursements related to millions of dollars in project-related costs.

  For the selected districts where independent audits were conducted, it appears the auditors generally concentrated their audit work on the financial statements and related activity of the applicable TDD, which did not include any expenditures incurred directly by the developer(s). While any subsequent reimbursements to the developer would be reflected in the TDD's financial statements and activity, there was generally little or no documentation indicating the reimbursements were reviewed by the auditors, and it appears they generally relied on the TDD, city or trustee officials to ensure any such reimbursements were proper.

The payment of significant project costs by the developer complicates the audit process and weakens the accountability over project-related costs. Considering this situation, the need for an independent review or oversight of a TDD's expenditures by the transportation authority or other public entity, as noted above, is even more critical.

- **The revenues of TDDs located in TIF areas are being handled in different manners, and in some instances there is not adequate assurance TDD sales tax revenues are only used to pay the TDD's share of bond financing costs.**

  As discussed earlier, some TDDs are either completely or partially in a TIF area. Section 99.845, RSMo, provides that 50 percent of the additional tax revenues generated in such TIF areas are to be used for the purposes of that particular TIF area. Nine of the selected districts were located in a TIF area, and in several of the districts the related funding was handled differently than described in that section of law.

  During our review of the selected TDDs, we noted that 5 of the 9 districts located in a TIF area had a cooperative agreement with the city which allowed the TDD to apply most, if not all, of its sale tax revenue to its own transportation project costs. In contrast, we noted that 3 other districts disburse all their sales tax revenue, less an amount needed to cover the administrative costs of the district, to the local municipality (city) to pay the debt service costs of the city's tax increment financing (TIF) bonds. This apparently occurred because the applicable cities used TIF bonds to finance both the TDDs' transportation projects and the cities' redevelopment (TIF) projects. Each of these TDDs entered into intergovernmental agreements with the respective city whereby all the TDD's revenues, less administrative costs, were to be disbursed to the city until the TIF bonds were retired. These agreements did not include provisions ensuring the TDD sales tax revenues would only be used to pay the TDD's share of the bond financing costs. For one other TDD, 50 percent of the TDD's revenues are disbursed to the city for TIF purposes. Because this TDD's projects were also financed with the applicable city's TIF bonds, most of the TDD's remaining revenues are disbursed to the city to pay the TIF debt of the city. However, for this TDD an agreement provides that in no instance shall the TDD revenues be applied to the payment of more than a specified percentage (the TDD-portion of the debt). Any TDD revenue in excess of that debt liability is disbursed to the TDD.

  In situations where TDDs are turning over their sales tax revenues to a city to liquidate TIF bond debt, any agreements supporting such arrangements should include provisions that ensure the district's revenues are only used to pay the TDD's share of the bond financing costs.

  WE RECOMMEND the General Assembly review the public awareness, accountability, and compliance issues addressed in this report and work with

MoDOT, the State Auditor's Office, and other governmental entities to make necessary revisions to the TDD-related statutes.

MoDOT'S COMMENTS

As you are aware, Missouri has many more transportation needs than can be funded with existing revenues. In some instances, TDDs have provided funds for state system highway improvements that might not have been built were it not for the additional funds provided by the TDDs. We report the dollars generated through cost-sharing and other partnering agreements, such as TDDs, in our performance measurement tool, TRACKER. During fiscal year 2005, $65.5 million in additional state transportation system improvements were generated through such agreements.

In 2005, MoDOT supported Senate Bill 77. That proposed legislation included many of the safeguards mentioned in the audit report. For example, the bill required the appropriate transportation authorities to approve projects before filing TDD court petitions and submit TDD tax increases to voters. The bill also contained a provision to help the State Auditor's Office meet its requirements to audit each TDD every three years. Unfortunately, the legislation did not pass.

As your report noted, MoDOT provides financial and/or project management on many TDD projects, particularly those that substantially involve the state highway system. We will continue to do so. We would also be happy to work with the General Assembly on future TDD legislation.

Review of Selected Districts

The following section reports information related to the 16 TDDs that were selected for a more in-depth review. The selected districts represented TDDs that had operated, and had financial activity, for at least three complete fiscal years as of December 31, 2004[1]. The selected districts are presented in the order of date established. A Schedule of Receipts, Disbursements, and Cash Balances for the selected districts is located at Appendix E.

- **210 Highway TDD**

  The 210 Highway TDD was organized in September 1997 by petition of the owner of property within the proposed district. The district's developer was also the property owner at the time the district was established. In 2000, the property was sold to another corporation. The TDD's Board of Directors and officers are representatives of the current owner.

  The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective December 1, 1997. In addition, a property tax of up to $.10 per $100 assessed valuation was approved, with the property tax ranging from $.0497 to $.0577 per $100 assessed valuation. The property taxes levied by the district are capped at $30,000 annually.

  The sales tax and property tax levy are currently expected to remain in effect for 20 years unless terminated sooner. The retail establishments collect the sales tax revenues and the county collector collects the property taxes, with both being forwarded to a private contractor, which serves as the district's collection agent.

  The TDD is located in the city of Kansas City, in Clay County, and has a fiscal year end of March 31. Annual financial audits of the district have been conducted by an independent CPA firm.

  The district was formed for the purpose of constructing the following transportation projects with a total estimated cost of approximately $8.6 million:

  - Widening of Missouri 210 Highway from two lanes to four lanes
  - Construction of two bridges
  - Street lights

  The MoDOT is the public entity with jurisdiction over these projects and it accepted dedication of the projects upon their completion.

[1] The Platte County Missouri South II TDD, while not having operated for three complete fiscal years, was included in this additional review because of its close association with the Platte County Missouri South I TDD and because the survey information provided by these two TDDs was reported to us in a consolidated manner. Because of this, these two districts are reported in a combined manner.

The district issued $7,115,000 and $1,895,000 in Series A and B revenue bonds, respectively, in 1999 to finance its projects. Prior to the issuance of the bonds, the developer financed the costs incurred related to the TDD's formation, project design and engineering. After the revenue bonds were issued, the developer was reimbursed for the costs incurred. A portion of the district's bond proceeds were used to finance and accelerate a transportation project that MoDOT had planned to construct in 2006. As a result, MoDOT agreed to repay the principal on the Series A bonds in the amount of approximately $6.6 million beginning in 2006. As of December 31, 2004, this was the only TDD for which MoDOT had committed funding.

MoDOT provided independent oversight on these projects and was responsible for the projects' construction and the review and approval of contractor invoices prior to payment.

- **Gravois Bluffs TDD**

The Gravois Bluffs TDD was organized in December 1999 by petition of the two owners of property within the proposed district, one being the city of Fenton. The district's developer was the other property owner. The TDD's Board of Directors and officers are employees of the developer.

The qualified voter(s) of the district, in this case the two property owners, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective October 1, 2000. The sales tax is currently expected to remain in effect for 11½ years unless terminated sooner. The retail establishments collect the sales tax and forward the collections to the city of Fenton, which serves as the district's collection agent.

The TDD is located in the city of Fenton, in St. Louis County, and has a fiscal year end of December 31. Annual financial audits of the district have been conducted by an independent CPA firm since its inception.

The district was formed for the purpose of constructing the following transportation projects with an estimated cost of approximately $12.7 million:

- Gravois Road and South Old Highway 141 connection streets
- Highway 141 intersection
- Country Home Road and Old Smizer Mill Road connection street
- Curbs, gutters, sidewalks, storm water facilities, traffic signalization, as needed.

The city of Fenton is the public entity with jurisdiction over these projects and it will accept dedication of the projects upon completion.

Because the district is located within a TIF area, 50% of the sales tax collected has been paid to the city of Fenton for deposit to the accounts relating to the TIF projects.

The city of Fenton issued $39,610,000 and $19,035,000 in TIF bonds in 2001 and 2002, respectively, to finance the district's projects and other TIF projects. Prior to the issuance of the TIF revenue bonds, the developer financed the cost of the TDD projects and received TDD and TIF notes. When the TIF revenue bonds were issued, the notes were retired. Pursuant to a formal agreement with the city, the district has agreed to disburse all the TDD sales tax revenues, less administrative and collection costs, to the city to pay debt service on the TIF bonds until they are retired. The agreement did not include provisions ensuring the TDD sales tax revenues would only be used to pay the TDD's share of the bond financing costs.

The city of Fenton has provided some independent oversight and was responsible for the review and approval of contractor invoices prior to issuing the TDD and TIF notes.

- **Strother Interchange TDD**

  The Strother Interchange TDD was organized in January 2000 by petition of the owner of property within the proposed district. The district's developer was the property owner. The TDD's Board of Directors and officers are employees of the developer and its affiliates.

  The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one-half of one percent (0.50%) sales tax on all transactions which are taxable within the boundaries of the district, effective May 1, 2000. The sales tax is currently expected to remain in effect for 20 years unless terminated sooner. The retail establishments collect the sales tax and forward the collections to a private contractor acting as the district's collection agent.

  The TDD is located in the city of Lee's Summit, in Jackson County, and has a fiscal year end of December 31. Annual financial audits of the district have been conducted by an independent CPA firm since its inception.

  The district was formed for the purpose of acquiring and constructing the following transportation projects with an estimated cost of approximately $25.8 million:

  - I-470 and Strother Road interchange
  - Strother Road intersection with Independence Avenue and Ralph Powell Road
  - East Road design and construction
  - Ralph Powell Road realignment and reconstruction

The city of Lee's Summit and MoDOT are the public entities with jurisdiction over these projects and which will accept dedication of the projects upon completion.

The district is located within a TIF area, with the TDD and TIF area having the same geographic boundaries and funding the same projects. Pursuant a formal agreement, the city of Lee's Summit has agreed to allow the TIF portion of the TDD sales tax to be retained by the district and applied to its debt service costs.

The district issued $8,530,000 in revenue bonds in 2004 to finance a portion of the costs of the projects. Prior to the issuance of the revenue bonds, the developer financed some costs of the TDD projects. When the TDD revenue bonds were issued, the developer was reimbursed and all subsequent costs were paid with the remaining bond proceeds.

According to a TDD representative, road work was started prior to the legal establishment of the district. It is unclear whether the provisions of Chapter 238, RSMo, allow the construction of a transportation project prior to the TDD being legally established.

The city of Lee's Summit has provided some independent oversight and was responsible for reviewing and approving contractor invoices prior to payment by the trustee.

- **Fenton Crossing TDD**

The Fenton Crossing TDD was organized in February 2000 by petition of the owner of property within the proposed district. The district's developer was also the owner of the property. The TDD's Board of Directors and officers are employees of the developer.

The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective July 1, 2000. The sales tax is currently expected to remain in effect for 20 years unless terminated sooner. The retail establishments collect the sales tax and forward the collections to the city of Fenton, which serves as the district's collection agent.

The TDD is located in the city of Fenton, in St. Louis County, and has a fiscal year end of December 31. Annual financial audits of the district have not been conducted.

The district was formed for the purpose of acquiring and constructing the following transportation projects with an estimated cost of approximately $4.5 million:

- Country Home Drive extension
- Traffic signals along Highway 141
- Offsite road work
- Bridges
- Purchase of a Break in Access to Route 141

The city of Fenton is the public entity with jurisdiction over these projects and accepted dedication of the projects upon completion.

Because the district is located within a TIF area, 50% of the sales tax collected is paid to the city of Fenton for deposit to the accounts relating to the TIF projects.

The city of Fenton issued $10,205,000 in TIF bonds in 2000 to finance the district's projects and other TIF projects. During the construction stage of the projects, the developer financed the project costs. When the projects were completed, the developer was reimbursed with TIF bond revenues. Pursuant to a lease agreement with the city, the district agreed to disburse all of its sales tax revenues, less administrative costs, to the city to pay the debt service on the TIF bonds until they are retired. The agreement did not include provisions ensuring the TDD sales tax revenues would only be used to pay the TDD's share of the bond financing costs.

The district's board was responsible for overseeing the projects' construction and the review and approval of contractor invoices. No independent oversight or review of this TDD's expenditures has been performed by the local transportation authority.

- **Kenilworth TDD**

The Kenilworth TDD was organized in August 2000 by petition of the owner of property within the proposed district. The district's developer was also the property owner. The TDD's Board of Directors and officers are employees of the developer.

The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one-fourth of one percent (0.25%) sales tax on all transactions which are taxable within the boundaries of the district, effective January 1, 2001. The sales tax is currently expected to remain in effect for 14½ years unless terminated sooner. The retail establishments collect the sales tax and forward the collections to the city of Brentwood, which serves as the district's collection agent.

The TDD is located in the city of Brentwood, in St. Louis County, and has a fiscal year end of December 31. Annual financial audits of the district have been conducted by an independent CPA firm since its inception.

The district was formed for the purpose of constructing the following transportation projects with an estimated cost of approximately $1.5 million:

- Strassner Avenue extension
- Wrenwood Lane and Brentwood Boulevard intersection reconfiguration
- Additional traffic lanes along Brentwood Boulevard and Eager Road
- Eager Road and Brentwood Boulevard intersection reconfiguration
- Curbs, gutters, sidewalks, storm water facilities, traffic signalization, as needed.

The city of Brentwood is the public entity with jurisdiction over these projects and accepted dedication of the projects upon completion.

Because the district is located within a TIF area, 50% of the sales tax collected is is paid to the city of Brentwood for deposit to the accounts relating to the TIF projects.

The city of Brentwood issued $15,660,000 in TIF bonds in 2001 to finance the district's projects and the city's TIF projects. Pursuant to a formal agreement with the city, the district agreed to disburse all its sales tax revenues, less administrative and collection costs, to the city to pay the debt service on the TIF bonds until they are retired. The agreement did not include provisions ensuring the TDD sales tax revenues would only be used to pay the TDD's share of the bond financing costs.

The city of Brentwood has provided some independent oversight and was responsible for overseeing the project's construction and the review and approval of contractor invoices prior to payment by the trustee.

- **Douglas Square TDD**

The Douglas Square TDD was organized in September 2000 by petition of the four owners of property within the proposed district. The district's developer was the owner of a majority of the property in the district. In 2002, the developer sold its property and interests in the development to another corporation. The TDD's Board of Directors and officers are employees or representatives of the current property owners.

The qualified voter(s) of the district, consisting of the property owners, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective June 1, 2001. The sales tax is currently expected to remain in effect for 20 years unless terminated sooner.

The retail establishments collect the sales tax and mail the collections directly to the district's bank. The district's collection agent is a private contractor.

The TDD is located in the city of Lee's Summit, in Jackson County, and has a fiscal year end of December 31. Annual financial audits of the district have not been conducted.

The district was formed for the purpose of designing, engineering and constructing an extension to Missouri Road, with an estimated cost of approximately $450,000.

The city of Lee's Summit is the public entity with jurisdiction over this project and accepted dedication of the project upon completion.

The district obtained a $550,000 commercial loan to finance the costs of the project. Prior to the district's loan, the developer had funded the project by obtaining a private loan. After the district's loan was obtained, the developer was reimbursed for the costs incurred.

The TDD's petition indicated portion of the project was started &/or completed prior to the legal establishment of the district. It is unclear whether the provisions of Chapter 238, RSMo, allow the construction of a transportation project prior to the TDD being legally established.

The city of Lee's Summit has provided some independent oversight and was responsible for overseeing the project's construction and the review and approval of contractor invoices prior to the developer being reimbursed. The district's board chairman reviews and approves all general operating expenditures prior to payment by a private contractor.

- **Boonville Riverfront TDD**

The Boonville Riverfront TDD was organized in February 2001 by petition of the owner of the property within the proposed district and the property's leaseholder. The district's property owner is the city of Boonville and the developer is the leaseholder. The district's Board of Directors and officers were appointed by the city's mayor and city council.

The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective December 1, 2001. The sales tax is currently expected to remain in effect for 40 years unless terminated sooner. The retail establishment collects the sales tax and forwards the collections to the city of Boonville, which serves as the district's collection agent.

The TDD is located in the city of Boonville, in Cooper County, and has a fiscal year end of December 31. Annual financial audits of the district have not been conducted.

The district was formed for the purpose of constructing the following transportation projects with an estimated cost of approximately $3.9 million:

- Traffic signals along Main Street at the intersection of Spring Street and Morgan Street
- Santa Fe Trail and Spring Street realignment and reconstruction
- Second Street extension
- Highway B and Highway 5 turn lanes
- Signage at various intersections

The city of Boonville and MoDOT are the public entities with jurisdiction over these projects and which will accept dedication of the projects upon completion.

According to a city official, as of June 2005, none of the transportation projects have been started, nor are there plans to start them in the foreseeable future. The petition to establish the district indicated the city of Boonville initially planned to loan the district $1.15 million to fund the transportation projects; however, the city administration has since changed and it is currently thought the projects will not be constructed until sufficient revenues have been accumulated to fund the projects.

Considering the city of Boonville was involved with the creation of the TDD and the expenses of this district have been minimal, independent oversight does not appear to be an issue at this time.

- **I-470 and I-350 TDD**

The I-470 and I-350 TDD was organized in March 2001 by petition of the owner of property within the proposed district. The district's developer was also the property owner. The TDD's Board of Directors and officers are employees of the developer.

The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective October 1, 2001. The sales tax is currently expected to remain in effect for 40 years unless terminated sooner. The retail establishments collect the sales tax and forward the collections to the city of Lee's Summit, which serves as the district's collection agent.

The TDD is located in the city of Lee's Summit, in Jackson County, and has a fiscal year end of December 31. Annual financial audits of the district have been conducted by an independent CPA firm since its inception.

The district was formed for the purpose of acquiring and constructing the following transportation projects with an estimated cost of approximately $17 million:

- Acquisition of highway right-of-way
- Construct a four lane divided parkway from I-470 to Chipman Road
- Construct highway ramps on US 50 and Chipman Road
- Chipman Road turn lanes
- Traffic signals and raised median
- Through lanes

The city of Lee's Summit and MoDOT are the public entities with jurisdiction over these projects and which will accept dedication of the projects upon completion.

The district is located within a TIF area, thus, the city of Lee's Summit could claim 50 percent of the sales tax collected for purposes of the TIF. However, per a formal agreement, the city has agreed that the TIF portion of the TDD sales tax will be remitted to the trustee and applied to the district's debt service costs.

The district issued $14,755,000 in revenue bonds in 2001 to finance the costs of the projects.

According to a TDD representative, work on some of the projects was started prior to the legal establishment of the district. It is unclear whether the provisions of Chapter 238, RSMo, allow the construction of a transportation project prior to the TDD being legally established.

The city of Lee's Summit has provided some independent oversight related to the projects' construction and performed a review and approval of contractor invoices and district administrative costs prior to payment by the trustee.

- **Ballwin Towne Center TDD**

The Ballwin Towne Center TDD was organized in April 2001 by petition of the owner of property within the proposed district. The district's developer was also the property owner at the time the district was established. In December 2002, the developer sold the property and its interests in the development to another corporation. The TDD's Board of Directors and officers are employees of the current property owner.

The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one-fourth of one percent (0.25%) sales tax on all transactions which are taxable within the boundaries of the district, effective October 1, 2001. The sales tax is currently expected to remain in effect for 21 years unless

terminated sooner. The retail establishments collect the sales tax and forward the collections to the city of Ballwin, which serves as the district's collection agent.

The TDD is located in the city of Ballwin, in St. Louis County, and has a fiscal year end of December 31. Annual financial audits of the district have not been conducted.

The district was formed for the purpose of constructing the following transportation projects with an estimated cost of approximately $1.3 million:

- Seven Trails Drive and Kehrs Mill connector road
- Holloway and Kehrs Mill traffic signal and related improvements

The city of Ballwin is the public entity with jurisdiction over these projects and accepted dedication of the projects upon completion.

The district is located within a TIF area, thus, 50 percent of the sales tax collected is paid to the city of Ballwin for deposit to the accounts relating to the TIF projects.

The city of Ballwin issued $20.1 million in TIF bonds in 2002 to finance the district's projects and other TIF projects. Prior to the issuance of the TIF bonds, the developer financed the cost of the district's projects. When the TIF revenue bonds were issued, the developer was reimbursed for the costs incurred. Pursuant to a formal agreement with the city, the district agreed to pay the debt service costs on the portion of TIF revenue that was used for the transportation projects, with the district's revenue limit set at 6.661% of the TIF debt service costs.

The city of Ballwin has provided some independent oversight related to the projects' construction and performed a review and approval of contractor invoices and district administrative costs prior to payment by the trustee.

- **Brentwood Pointe TDD**

The Brentwood Pointe TDD was organized in May 2001 by petition of the two owners of property within the proposed district. All of the property owners are affiliates of the district's developer. The TDD's Board of Directors and officers are employees of the developer.

The qualified voters of the district, in this case the property owners, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective January 1, 2002. The sales tax is currently expected to remain in effect for 20 years unless terminated sooner. The retail establishments collect the sales tax and forward the collections to the city of Brentwood, which serves as the district's collection agent.

The TDD is located in the city of Brentwood, in St. Louis County, and has a fiscal year end of December 31. Annual financial audits have been conducted of the TDD by an independent CPA firm since its inception.

The district was formed for the purpose of acquiring and constructing the following transportation projects with an estimated cost of approximately $5.1 million:

- Eager Road improvements
- Overpass improvements
- Hanley Industrial Drive extension

The city of Brentwood and St. Louis County are the public entities with jurisdiction over these projects and accepted dedication of the projects upon completion.

The district is located within a TIF area, thus, the city of Brentwood could claim 50 percent of the sales tax collected for purposes of the TIF. However, per a formal agreement, the city has agreed that the TIF portion of the TDD sales tax will be remitted to the trustee and applied to the district's debt service costs.

The district issued $6.8 million in revenue bonds in 2001 to finance the costs of the projects. Prior to the issuance of the revenue bonds, the district obtained a bank loan to finance the cost of the TDD projects. When the TDD revenue bonds were issued, the bank loan was repaid.

The city of Brentwood has provided some independent oversight related to the review and approval of contractor invoices and administrative costs after district approval and prior to payment by the trustee.

- **Platte County Missouri South I and II TDDs**

The Platte County Missouri South I and II TDDs were organized in June 2001 and April 2002, respectively, by petition of the owner of property within the proposed districts. The districts were petitioned and organized separately and represent separate political subdivisions; however, their borders connect, they have the same property owner/developer, and they reported their activities and operations to us on a consolidated basis. Therefore, we have reported on them together for purposes of this review. The TDDs' have separate boards and officers, but they are made up of the same individuals who are employees of an affiliate of the developer.

The qualified voter(s) of the districts, in this case the property owner, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the districts, effective September 1, 2001. The sales tax is currently expected to remain in effect for 30 years unless terminated

sooner. The retail establishments collect the sales tax and mail the collections directly to the district's bank. The district's collection agent is a private contractor.

The TDDs are located in the city of Kansas City, in Platte County, and have a fiscal year end of December 31. Annual financial audits had not been conducted prior to FY 2004; however, as of August 2005, the districts were in the process of receiving a FY 2004 financial audit performed by an independent CPA firm.

The districts were formed for the purpose of constructing the following transportation projects with an estimated cost of approximately $24 million:

- Northwest Prairie View Road
- North Congress Avenue, including sidewalks, bridge crossings, and traffic circles
- M-152 and Congress Interchange
- Break in access study
- Vehicle and pedestrian bridges
- Underground utilities
- 86th Street and Rush Creek Parkway
- Street lighting, trees, sidewalks, greenway stabilization for trails
- Pedestrian walkways, trail head, rest stations, bike trails, trolley/bus, rest shelters
- Sidewalks, curbs and gutters
- Barry Road widening
- I-29 off-ramp widening

The city of Kansas City and MoDOT are the public entities with jurisdiction over these projects and which will accept dedication of the projects upon completion.

The Industrial Development Authority, an entity given development authority within the city of Kansas City, issued $19.7 million in revenue bonds in 2003 to finance the districts' projects. Prior to the issuance of the revenue bonds, the developer financed the project costs. When the revenue bonds were issued, the developer was reimbursed and all subsequent project costs were paid from the bond proceeds.

The districts' boards were responsible for the projects' construction and the review and approval of contractor invoices. No independent oversight or review of these TDDs' expenditures has been performed by the applicable transportation authorities.

- **Truman Road TDD**

The Truman Road TDD was organized in June 2001 by petition of the owner of property within the proposed district. The district's developer is also the property

owner. The TDD's Board of Directors and officers are employees/representatives of the developer.

The qualified voter(s) of the district, in this case the property owner, approved the imposition of a one percent (1%) sales tax on all transactions which are taxable within the boundaries of the district, effective October 1, 2001. The sales tax is currently expected to remain in effect for 40 years unless terminated sooner. The retail establishment collects the sales tax and forwards the collections to the district's collection agent, a private contractor.

The district is located in the city of Independence, in Jackson County, and has a fiscal year end of December 31. A financial audit was conducted by an independent CPA firm for fiscal year 2001, but no audits have been conducted since that time.

The TDD was formed for the purpose of the design and construction of streetscape improvements along a portion of Truman Road, with an estimated cost of approximately $233,000.

The city of Independence and MoDOT are the public entities with jurisdiction over and which will accept dedication of the project upon completion.

The TDD is located within a TIF area, thus, the city of Independence has a claim to 50 percent of the sales tax collected for purposes of the TIF. However, per a formal agreement, the city has agreed to allow the district to retain the TIF portion of the revenues to pay for the transportation project.

According to a representative of the district, as of July 2005, the transportation project has not started and no timetable has been established regarding the construction and completion of the project. The representative indicated the project is on a pay-as-you-go schedule and no financing will be obtained.

The district's board is responsible for overseeing the TDD administrative operations, future project construction, and the review and approval of invoices prior to payment. No independent oversight or review of this TDD's expenditures has been performed by the applicable transportation authorities.

- **Country Club Plaza of Kansas City, MO TDD**

The Country Club Plaza of Kansas City, MO TDD was organized in July 2001 by petition of the three owners of property within the proposed district. The district's developer was one of the property owners. The TDD's Board of Directors and officers are employee/representatives of the property owners.

The qualified voter(s) of the district, in this case the property owners, approved the imposition of a one-half of one percent (0.50%) sales tax on all transactions

which are taxable within the boundaries of the district, effective November 1, 2001. The sales tax is currently expected to remain in effect for 20 years unless terminated sooner. The retail establishments collect the sales tax and forward the collections to a private contractor, which serves as the district's collection agent.

The district is located in the city of Kansas City, in Jackson County, and has a fiscal year end of December 31. Annual financial audits have been conducted by an independent CPA firm since its inception.

The TDD was formed for the purpose of constructing the following transportation projects with an estimated cost of approximately $11.1 million:

- A 495-space parking garage at the intersection of 47th Street and Pennsylvania Avenue
- The rehabilitation of other parking garages, if funding is available

The city of Kansas City is the public entity with jurisdiction over the projects and which will accept dedication of the projects upon completion for a period of 24 years.

The TDD is located within a TIF area, thus, the TIF Commission of Kansas City has a claim to 50 percent of the sales tax collected for purposes of the TIF. However, per a formal agreement, the TIF Commission agreed the TIF-related revenues, less 5 percent, would be remitted to the trustee and applied to the district's debt service costs.

The district issued $12.8 million in revenue bonds in 2002 to finance the costs of the projects. Prior to issuance of the bonds, the developer financed the project costs. When the revenue bonds were issued, the developer was reimbursed.

The district's board was responsible for overseeing the projects' construction and the review and approval of contractor invoices. No independent oversight or review of this TDD's expenditures has been performed by the local transportation authority.

- **Wentzville TDD**

The Wentzville TDD was organized in November 2001 by petition of the five owners of property within the proposed district. The district's developers were two of the property owners. The TDD's Board of Directors and officers are employees of the two developers.

The qualified voter(s) of the district, in this case the property owners, approved the imposition of a one-fourth of one percent (0.25%) sales tax on all transactions which are taxable within the boundaries of the district, effective December 1, 2001. The sales tax is currently expected to remain in effect for 15 years unless

terminated sooner. The retail establishments collect the sales tax and forward the collections to the city of Wentzville, which serves as the district's collection agent.

The district is located in the city of Wentzville, in St. Charles County, and has a fiscal year end of December 31. Annual financial audits have been conducted by an independent CPA firm since its inception.

The TDD was formed for the purpose of constructing the following transportation projects with an estimated cost of approximately $3.1 million:

- Pearce Boulevard overpass enhancements
- Pearce Boulevard/Wentzville Parkway interchange
- Pearce Boulevard extension to May Road
- Local transit system

The city of Wentzville and MoDOT are the public entities with jurisdiction over the projects and which will accept dedication of the projects upon completion.

The TDD issued $3.97 million in revenue bonds in 2002 to finance the costs of the projects. Prior to issuance of the bonds, the developers financed the cost of the district's formation and various project costs. When the revenue bonds were issued, the developers were reimbursed and all subsequent project costs were paid from the bond proceeds.

The district's project improvement budget indicated a few of the projects were completed prior to the legal establishment of the district. It is unclear whether the provisions of Chapter 238, RSMo, allow the construction of a transportation project prior to the TDD being legally established.

The district's board was responsible for overseeing the projects' construction and the review and approval of contractor invoices prior to payment by the trustee. No independent oversight or review of this TDD's expenditures has been performed by the applicable transportation authorities.

- **Shoppes at Old Webster TDD**

The Shoppes at Old Webster TDD was organized in November 2001 by petition of the three owners of property within the proposed district.

The qualified voter(s) of the district, in this case the property owners, approved the imposition of a five-eights of one percent (0.625%) sales tax on all transactions which are taxable within the boundaries of the district, which became effective in 2001. The sales tax is currently expected to remain in effect for 20 years unless terminated sooner. The district's collection agent is a private contractor.

The district is located in the city of Webster Groves, in St. Louis County, and has a fiscal year end of December 31. Annual financial audits have not been conducted.

The TDD was formed for the purpose of constructing a two-level parking garage at an estimated cost of approximately $520,000.

The city of Webster Groves is the public entity with jurisdiction over the project and which will accept dedication of the project upon completion.

The district obtained a $450,000 bank loan to finance the transportation project.

We requested other information about this TDD which we had planned to present in our report including, but not limited to: the composition of the TDD board, the manner in which revenues are collected and remitted to the district, how project costs were financed prior to the district securing the bank loan, if applicable, and those parties/entities who have had involvement or responsibility for overseeing the costs incurred by the district. However, as of September 30, 2005, we had not received the additional information requested.

APPENDIXES

APPENDIX A

TRANSPORTATION DEVELOPMENT DISTRICTS
INFORMATION REGARDING ESTABLISHMENT OF TDDs (IN ORDER OF DATE ESTABLISHED)

District Name	Date Established	County	Municipality	Petition To Establish Was Filed By:	Number of Property Owners
210 Highway	09/23/97	Clay	Kansas City	Property Owners	1
Gravois Bluffs	12/07/99	St. Louis	Fenton	Property Owners & City of Fenton	2
Strother Interchange	01/21/00	Jackson	Lee's Summit	Property Owners	1
Fenton Crossing	02/08/00	St. Louis	Fenton	Property Owners	1
Kenilworth	08/15/00	St. Louis	Brentwood	Property Owners	1
Meramec Station Road and Highway 141	09/07/00	N/A	St. Louis	Property Owners	2
Douglas Square	09/21/00	Jackson	Lee's Summit	Property Owners	4
370 Missouri Bottom Road/Taussig Road	11/01/00	St. Louis	Bridgeton/Hazelwood	Property Owners	2
Boonville Riverfront	02/09/01	Cooper	Boonville	Property Owners & City of Boonville	1
Mark Twain Mall	02/20/01	St. Charles	St. Charles	Property Owners	1
I-470 and I-350	03/17/01	Jackson	Lee's Summit	Property Owners	1
St. John Church Road	04/17/01	N/A	St. Louis	Property Owners	9
Ballwin Towne Center	04/26/01	St. Louis	Ballwin	Property Owners	1
Brentwood Pointe	05/16/01	St. Louis	Brentwood	Property Owners	2
Platte County Missouri South I	06/19/01	Platte	Kansas City	Property Owners	3
Big Bend Crossing	06/25/01	St. Louis	Crestwood	Property Owners & City of Crestwood	1
Truman Road	06/25/01	Jackson	Independence	Property Owners	1
Country Club Plaza of Kansas City, Missouri	07/12/01	Jackson	Kansas City	Property Owners & TIF Commission of KC	3
Stardust-Munger-Diamond	10/16/01	Marion	Hannibal	Property Owners & City of Hannibal	1
Interstate Plaza/North Town Village	11/06/01	Pulaski	St. Robert	Property Owners & City of St. Robert	27
Wentzville	11/16/01	St. Charles	Wentzville	Property Owners	5
Shoppes at Old Webster	11/29/01	St. Louis	Webster Groves	Property Owners	3
Platte County Missouri South II	04/12/02	Platte	Kansas City	Property Owners	1
Thirty-Ninth Street	04/25/02	Jackson	Independence	City of Independence	**
St. John Crossings	06/25/02	St. Louis	St. John	Property Owners & City of St. John	1
Douglas Station	06/27/02	Jackson	Lee's Summit	Property Owners	1
CenterState	08/05/02	Boone	Columbia	Property Owners	1
Raintree North	08/19/02	Jackson	Lee's Summit	Property Owners	1
Shoppes at Cross Keys	09/18/02	St. Louis	Florissant	Property Owners	1
Station Plaza	12/04/02	St. Louis	Kirkwood	Property Owners & City of Kirkwood	1
Hanley/Eager Road	12/16/02	St. Louis	Brentwood	Property Owners	6
US Highway 65 and Truman Dam Access	03/12/03	Benton	Warsaw	Property Owners	1
Lake of the Woods	03/24/03	Boone	Columbia	Property Owners	2
I-70 and Adams Dairy Parkway	03/25/03	Jackson	Blue Springs	Property Owners	1
Ozark Centre	04/25/03	Christian	Ozark	Property Owners	1
Crestwood Point	05/15/03	St. Louis	Crestwood	Property Owners & City of Crestwood	2
M 150 and 135th Street	05/15/03	Jackson	Kansas City	Property Owners	1
Boscherts Landing	05/16/03	St. Charles	St. Peters	Property Owners	2
Salt Lick Road	05/16/03	St. Charles	St. Peters	Property Owners	1
Parkville Commons	06/09/03	Platte	Parkville	Property Owners	1
Pershall Road	07/30/03	St. Louis	Ferguson	Property Owners & City of Ferguson	1
Lee's Summit Missouri New Longview	07/31/03	Jackson	Lee's Summit	Property Owners	1
Prewitt Point	08/22/03	Miller	Osage Beach	Property Owners	2
Branson Regional Airport	09/04/03	Taney	Branson	Property Owners	1
WingHaven	09/11/03	St. Charles	O'Fallon	Property Owners	12
Merchant's Laclede	10/08/03	N/A	St. Louis	Property Owners	2
Belton Town Center	11/17/03	Cass	Belton	Property Owners	10
71 Highway & 150 Highway	11/20/03	Jackson	Grandview	Property Owners	2

APPENDIX A

TRANSPORTATION DEVELOPMENT DISTRICTS
INFORMATION REGARDING ESTABLISHMENT OF TDDs (IN ORDER OF DATE ESTABLISHED)

District Name	Date Established	County	Municipality	Petition To Establish Was Filed By:	Number of Property Owners
Brentwood/Strassner Road	02/24/04	St. Louis	Brentwood	City of Brentwood and St. Louis County	**
Hutchings Farm Plaza	03/04/04	St. Charles	O'Fallon	Property Owners	1
Mexico Road	04/08/04	St. Charles	O'Fallon	Property Owners	1
Southtown	04/12/04	N/A	St. Louis	Property Owners	1
Francis Place	04/13/04	St. Louis	Richmond Heights	Property Owners	1
Poplar Bluff Conference Center	05/04/04	Butler	Poplar Bluff	Property Owners	1
Eureka Commercial Park	05/10/04	St. Louis	Eureka	Property Owners	4
Hanley Road and North of Folk Avenue	05/19/04	St. Louis	Maplewood	Property Owners	1
Megan Shoppes	06/07/04	St. Charles	O'Fallon	Property Owners	2
Folk Avenue South	07/14/04	St. Louis	Maplewood	Property Owners	2
Hyannis Port Road	07/16/04	Jefferson	Hillsboro	Property Owners & Jefferson County	3
St. Joseph Gateway	07/20/04	Buchanan	St. Joseph	Property Owners	1
Park Hills	07/28/04	St. Francois	Park Hills	Property Owners	2
Hawk Ridge	09/02/04	St. Charles	Lake St. Louis	Property Owners & City of Lake St. Louis	3
Olive Boulevard	09/09/04	St. Louis	Creve Coeur	Property Owners & City of Creve Coeur	2
Shoppes at Stadium	09/27/04	Boone	Columbia	Property Owners	1
Stadium Corridor	10/04/04	Boone	Columbia	Property Owners	4
Troy/Lincoln County	10/05/04	Lincoln	Troy	City of Troy & Lincoln County	**
Chesterfield Commons	10/12/04	St. Louis	Chesterfield	Property Owners	1
Eureka Old Town	10/12/04	St. Louis	Eureka	Property Owners & City of Eureka	4
North Main/Malone	11/19/04	Scott	Sikeston	Property Owners	1

** The district has registered voters who approved the district's establishment.

Source: MoDOT TDD data base and the Judgement and Order issued by the Circuit Courts.

APPENDIX B

TRANSPORTATION DEVELOPMENT DISTRICTS
ESTIMATED TDD PROJECT COSTS AND ANTICIPATED REVENUES

District Name		Estimated Project Costs	TTD's Estimated Life	Total Anticipated Revenues**		TDD Within a TIF district?
210 Highway	$	8,587,389	11 Years	$ 5,972,759	1	No
Gravois Bluffs	*	12,764,073	11.5 Years	30,211,614		Yes
Strother Interchange		25,846,800	20 Years	4,231,781	1	Yes
Fenton Crossing	*	4,574,762	20 Years	8,000,000		Yes
Kenilworth	*	1,500,000	14.5 Years	3,859,150		Yes
Meramec Station Road and Highway 141		6,720,000	40 Years	15,700,000		Yes
Douglas Square		450,000	20 Years	4,320,746	2	No
370 Missouri Bottom Road/Taussig Road		34,010,000	17 Years	54,596,724		Yes
Boonville Riverfront		3,908,420	40 Years	4,000,000		No
Mark Twain Mall		1,500,000	30 Years	5,000,000		Yes
I-470 and I-350		17,080,627	40 Years	134,326,373	3	Yes
St. John Church Road		12,000,000	25 Years	27,000,000		No
Ballwin Towne Center	*	1,300,000	21 Years	5,751,400		Yes
Brentwood Pointe		5,101,697	20 Years	13,503,100		Yes
Platte County Missouri South I	*	24,000,000	30 Years	52,000,000		No
Big Bend Crossing		1,487,415	20 Years	2,500,000		No
Truman Road		232,700	21 Years	483,363		Yes
Country Club Plaza of Kansas City, Missouri		11,149,363	20 Years	30,163,825		Yes
Stardust-Munger-Diamond		4,704,000	19 Years	11,678,000		Yes
Interstate Plaza/North Town Village	*	3,980,000	20 Years	6,500,000		Yes
Wentzville	*	3,150,000	15 Years	5,921,700		No
Shoppes at Old Webster		520,000	20 Years	865,000		Yes
Platte County Missouri South II		-	-	-	4	No
Thirty-Ninth Street		15,075,640	23 Years	23,614,406		Yes
St. John Crossings		901,630	22 Years	2,354,600		Yes
Douglas Station		1,742,852	20 Years	3,461,671		No
CenterState		7,542,000	21 Years	8,000,000		No
Raintree North	*	1,700,000	14 Years	1,700,000		No
Shoppes at Cross Keys		4,900,000	23 Years	12,000,000		Yes
Station Plaza	*	1,550,000	25 Years	3,461,395		No
Hanley/Eager Road		12,000,000	30 Years	22,924,051		Yes
US Highway 65 and Truman Dam Access		2,000,000	25 Years	4,250,000		No
Lake of the Woods	*	2,700,000	30 Years	Unknown	5	No
I-70 and Adams Dairy Parkway	*	1,950,000	10 Years	1,883,723		No
Ozark Centre		3,408,293	20 Years	6,000,000		No
Crestwood Point		2,986,000	30 Years	4,827,000		Yes
M 150 and 135th Street		12,000,000	20 Years	18,817,000		No
Boscherts Landing		553,342	40 Years	Unknown	5	No
Salt Lick Road		1,406,281	30 Years	Unknown	5	No
Parkville Commons		8,000,000	22 Years	12,000,000		Yes
Pershall Road		620,000	25 Years	993,000		No
Lee's Summit Missouri New Longview		5,900,000	20 Years	10,500,000		Yes
Prewitt Point		4,750,000	25 Years	16,152,000		Yes
Branson Regional Airport	*	150,000,000	30 Years	Unknown	5	No
WingHaven		3,048,098	20 Years	8,178,263	6	No
Merchant's Laclede		6,510,000	30 Years	10,080,000		No
Belton Town Center	*	19,000,000	23 Years	5,480,360	1	Yes
71 Highway & 150 Highway		450,000	23 Years	763,850		Yes

APPENDIX B

TRANSPORTATION DEVELOPMENT DISTRICTS
ESTIMATED TDD PROJECT COSTS AND ANTICIPATED REVENUES

District Name		Estimated Project Costs	TTD's Estimated Life	Total Anticipated Revenues**		TDD Within a TIF district?
Brentwood/Strassner Road	*	8,365,000	11 Years	8,550,000		Yes
Hutchings Farm Plaza	*	600,000	8 Years	816,000		No
Mexico Road	*	2,600,000	40 Years	3,000,000		No
Southtown	*	1,231,292	23 Years	4,204,762		Yes
Francis Place		4,400,000	23 Years	10,000,000		Yes
Poplar Bluff Conference Center		2,400,000	40 Years	Unknown	5	No
Eureka Commercial Park		1,430,000	40 Years	Unknown	5	No
Hanley Road and North of Folk Avenue		16,300,000	25 Years	30,900,000		No
Megan Shoppes	*	1,145,834	40 Years	5,520,000		No
Folk Avenue South		6,958,609	26 Years	19,500,000		Yes
Hyannis Port Road		564,512	5 Years	650,000		No
St. Joseph Gateway	*	Unknown	23 Years	1,821,212	7	Yes
Park Hills	*	750,000	20 years	200,000	1	Yes
Hawk Ridge		19,400,000	25 Years	38,700,000		No
Olive Boulevard	*	4,500,000	20 Years	8,881,735		No
Shoppes at Stadium		2,500,000	15 Years	4,000,000		No
Stadium Corridor		13,819,603	25 Years	16,120,457		No
Troy/Lincoln County	*	14,000,000	20 Years	28,060,000		No
Chesterfield Commons		12,000,000	30 Years	Unknown	5	Yes
Eureka Old Town		1,367,500	30 Years	1,260,000	8	No
North Main/Malone	*	8,600,000	23 Years	1,398,084	1	Yes
	Total $	578,193,732	$	787,609,104		

* The amount of project costs and anticipated revenues presented were amended by a district official or representative from the amounts initially reported on the TDD survey questionnaire.

**Interest costs on TDD debt and administrative costs of the districts would appear to account for the difference between total estimated project costs and total anticipated revenues for many of the TDDs.

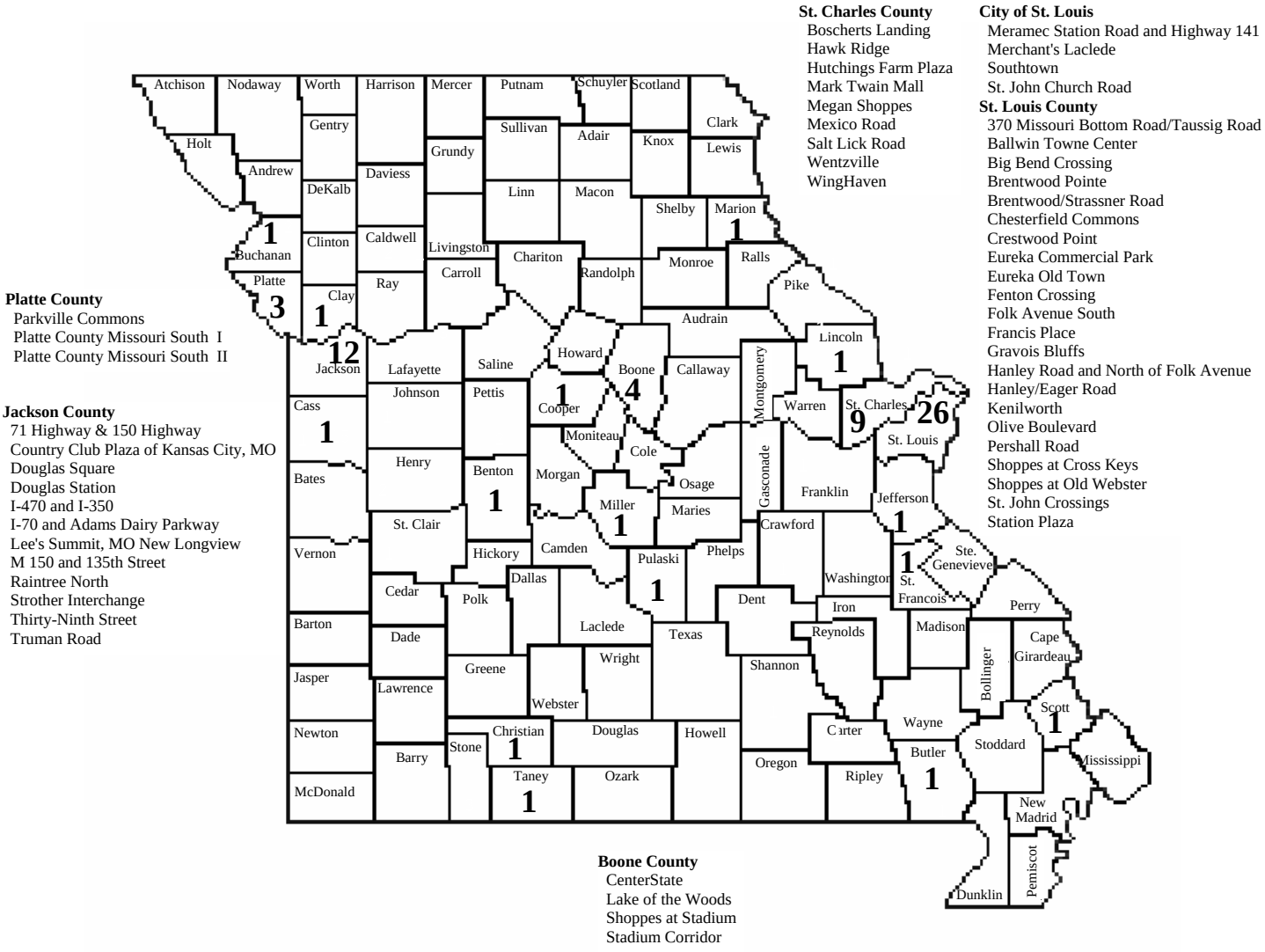
TIF - Tax Increment Financing - 50% of the sales tax collected is used for TIF projects unless an agreement specifies otherwise.

1. TDD sales tax revenues are used to supplement the project cost with the remaining project cost being funded from other revenue sources.
2. The additional revenue will be used to supplement the project cost related to an adjacent district.
3. The district's project(s) has several construction phases with estimated project costs provided only for Phase 1.
4. Project cost/life of district/anticipated revenue included in information presented for Platte County Missouri South I.
5. Anticipated revenues were not determined and sales tax will be collected until the project financing has been paid.
6. The estimated project costs reported by the district do not include an estimated annual expense of approximately $200,000 for a trolley service system.
7. Projects will be determined as revenue is received.
8. The district's project(s) was split into four phases and revenue was only estimated on two of the phases.

Source: TDD survey questionnaires and communication with district officials/representatives.

APPENDIX C

TRANSPORTATION DEVELOPMENT DISTRICTS
LOCATION OF TDDs BY COUNTY
(As of DECEMBER 31, 2004)



Platte County
Parkville Commons
Platte County Missouri South I
Platte County Missouri South II

Jackson County
71 Highway & 150 Highway
Country Club Plaza of Kansas City, MO
Douglas Square
Douglas Station
I-470 and I-350
I-70 and Adams Dairy Parkway
Lee's Summit, MO New Longview
M 150 and 135th Street
Raintree North
Strother Interchange
Thirty-Ninth Street
Truman Road

St. Charles County
Boscherts Landing
Hawk Ridge
Hutchings Farm Plaza
Mark Twain Mall
Megan Shoppes
Mexico Road
Salt Lick Road
Wentzville
WingHaven

City of St. Louis
Meramec Station Road and Highway 141
Merchant's Laclede
Southtown
St. John Church Road

St. Louis County
370 Missouri Bottom Road/Taussig Road
Ballwin Towne Center
Big Bend Crossing
Brentwood Pointe
Brentwood/Strassner Road
Chesterfield Commons
Crestwood Point
Eureka Commercial Park
Eureka Old Town
Fenton Crossing
Folk Avenue South
Francis Place
Gravois Bluffs
Hanley Road and North of Folk Avenue
Hanley/Eager Road
Kenilworth
Olive Boulevard
Pershall Road
Shoppes at Cross Keys
Shoppes at Old Webster
St. John Crossings
Station Plaza

Boone County
CenterState
Lake of the Woods
Shoppes at Stadium
Stadium Corridor

Note - of the twenty-six TDDs located in the area identified as St. Louis, twenty-two of the districts are located in St. Louis County and four are located in the city of St. Louis.

Source: MoDOT TDD database

APPENDIX D

TRANSPORTATION DEVELOPMENT DISTRICTS
TDD QUESTIONNAIRE

Name of TDD _____
(identify TDD on this line)

1. What is the TDD's fiscal year end (i.e. year ended 12/31/XX, year ended 3/31/XX, etc.)?
_____
_____

2. At the time TDD was established, what was the estimated total cost of constructing the project(s)/infrastructure (i.e. design costs, construction costs, etc.)?
_____
_____

3. How were the costs of the project(s)/infrastructure financed (i.e. revenue bonds, general obligation bonds, bank notes, pay-as-you-go, etc.), and the amount of that financing?_____
_____

4. At the time the TDD was established, what was the total estimated amount of revenues (sales taxes, property taxes, special assessments, etc.) to be collected and over what period of time?
_____
_____

5. When did the TDD begin collecting revenue?_____
_____

6. When did the TDD begin paying expenses related to its project(s) or operations?
_____
_____

7. Who collects the revenues for the TDD (i.e. TDD employees, the city, the county, a private contractor, etc.)? _____
_____

8. Who administers the funds of the TDD, including the handling of disbursements (i.e. TDD employees, the city, the county, a private contractor, bank trust department, etc.)?
_____
_____

APPENDIX D

TRANSPORTATION DEVELOPMENT DISTRICTS
TRANSPORTATION DEVELOPMENT DISTRICT QUESTIONNAIRE

9. Has the TDD had any financial audits conducted by a CPA firm? If so, please indicate the years that have been audited. _____
_____

10. In the spaces below please provide the requested information for the TDD's primary contact (please print):

Name of primary contact _____

Title (if applicable) _____

Mailing address _____

Email address _____

Phone number _____

_____
Preparer

_____
Date

TRANSPORTATION DEVELOPMENT DISTRICTS
SCHEDULE OF RECEIPTS, DISBURSEMENTS, AND CASH BALANCES - SELECTED TDDs

	210 Highway	Gravois Bluffs	Strother Interchange **	Fenton Crossing	Kenilworth
Beginning balance, Fiscal Year 2002	$ 159,313	412,660	4,021,828	76,301	26,594
Receipts:					
Sales tax	275,850	2,174,261	285,729	354,031	156,179
Property tax	29,157	0	0	0	0
Interest	5,693	0	91,789	982	314
Bond proceeds	0	0	0	0	0
Tax increment financing	0	0	957,963	0	0
Kansas City Municipal Assistance Corporation	0	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	940,563	0	0	0	0
Total Receipts	1,251,263	2,174,261	1,335,481	355,013	156,493
Disbursements:					
Bond issuance costs	0	0	0	0	0
Professional fees	15,489	26,995	89,059	13,708	0
Debt service	1,236,305	1,159,184	641,700	143,059	64,592
Insurance	3,078	0	14,234	3,483	0
Accounting and auditing	9,318	0	0	0	0
Administrative	0	0	0	0	2,951
City transportation project costs	0	0	0	0	0
Transportation project costs	0	0	2,476,111	0	0
Collection fees	0	21,488	0	4,020	0
Tax increment financing	0	1,159,184	0	234,334	76,893
Other	506	0	3,200	18	0
Total Disbursements	1,264,696	2,366,851	3,224,304	398,622	144,436
Ending Balance, Fiscal Year 2002	145,880	220,070	2,133,005	32,692	38,651
Receipts:					
Sales tax	330,721	2,529,428	216,162	383,713	191,772
Property tax	29,961	0	0	0	0
Interest	2,235	0	58,828	145	28
Bond proceeds	0	0	0	0	0
Tax increment financing	0	0	1,242,703	0	0
Kansas City Municipal Assistance Corporation	0	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	95,355	0	0	0	0
Total Receipts	458,272	2,529,428	1,517,693	383,858	191,800
Disbursements:					
Bond issuance costs	0	0	0	0	0
Professional fees	6,327	32,691	65,548	5,724	0
Debt service	407,482	1,205,074	1,351,700	178,275	97,491
Insurance	5,622	0	14,929	4,982	0
Accounting and auditing	2,445	0	0	0	0
Administrative	0	0	0	0	17,312
City transportation project costs	0	0	0	0	0
Transportation project costs	0	0	18,626	0	0
Collection fees	0	25,005	0	3,815	0
Tax increment financing	0	1,237,765	0	188,866	93,481
Other	267	0	6,855	64	0
Total Disbursements	422,143	2,500,535	1,457,658	381,726	208,284
Ending Balance, Fiscal Year 2003	182,009	248,963	2,193,040	34,824	22,167
Receipts:					
Sales tax	328,341	2,809,441	140,222	410,467	198,532
Property tax	29,533	0	0	0	0
Interest	1,587	0	47,821	148	0
Bond proceeds	0	0	0	0	0
Tax increment financing	0	0	1,548,581	0	0
Kansas City Municipal Assistance Corporation	0	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	20,095	0	0	0	0
Total Receipts	379,556	2,809,441	1,736,624	410,615	198,532
Disbursements:					
Bond issuance costs	0	0	343,014	0	0
Professional fees	3,445	57,750	26,904	2,409	0
Debt service	407,482	1,327,689	571,253	162,831	60,664
Insurance	4,356	0	16,207	5,204	0
Accounting and auditing	7,395	0	0	0	0
Administrative	0	0	0	0	29,227
City transportation project costs	0	0	0	0	0
Transportation project costs	0	0	0	0	0
Collection fees	0	27,686	0	3,711	0
Tax increment financing	0	1,370,475	0	234,061	113,200
Other	2,877	0	15,413	40	0
Total Disbursements	425,555	2,783,600	972,791	408,256	203,091
Ending Balance, Fiscal Year 2004	$ 136,010	274,804	2,956,873	37,183	17,608

** Non-cash items presented on the TDD's financial statements were not presented on this schedule.

Source: TDD Annual Financial Reports or Audit Reports.

APPENDIX E

TRANSPORTATION DEVELOPMENT DISTRICTS
SCHEDULE OF RECEIPTS, DISBURSEMENTS, AND CASH BALANCES - SELECTED TDDs

	Douglas Square *	Boonville Riverfront	I-470 and I-350	Ballwin Towne Center	Brentwood Pointe
Beginning balance, Fiscal Year 2002	$ 14,290	0	2,461,435	0	1,305,927
Receipts:					
Sales tax	58,508	27,811	1,616,870	106,099	369,448
Property tax	0	0	92,910	0	0
Interest	512	100	0	60	25,234
Bond proceeds	0	0	0	0	0
Tax increment financing	0	0	0	0	0
Kansas City Municipal Assistance Corporation	0	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	0	0	76,697	0	0
Total Receipts	59,020	27,911	1,786,477	106,159	394,682
Disbursements:					
Bond issuance costs	0	0	0	0	0
Professional fees	0	0	0	0	0
Debt service	3,304	0	897,915	34,191	388,013
Insurance	0	915	0	0	0
Accounting and auditing	0	0	0	0	0
Administrative	17,617	0	31,388	19,090	42,715
City transportation project costs	0	0	0	0	0
Transportation project costs	0	0	273,475	0	307,067
Collection fees	0	0	16,174	1,075	0
Tax increment financing	0	0	0	53,219	0
Other	0	0	0	0	9,156
Total Disbursements	20,921	915	1,218,952	107,575	746,951
Ending Balance, Fiscal Year 2002	52,389	26,996	3,028,960	(1,416)	953,658
Receipts:					
Sales tax	120,196	20,445	1,804,600	139,671	458,562
Property tax	0	0	0	0	0
Interest	28	65	71,225	25	22,420
Bond proceeds	0	0	0	0	0
Tax increment financing	0	0	0	0	0
Kansas City Municipal Assistance Corporation	0	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	0	0	0	0	0
Total Receipts	120,224	20,510	1,875,825	139,696	480,982
Disbursements:					
Bond issuance costs	0	0	0	0	0
Professional fees	0	0	0	0	0
Debt service	78,312	0	1,264,572	61,539	516,850
Insurance	0	915	0	0	0
Accounting and auditing	0	0	0	0	0
Administrative	23,724	0	12,758	6,921	17,197
City transportation project costs	0	0	0	0	0
Transportation project costs	0	0	0	0	0
Collection fees	0	0	18,382	1,383	0
Tax increment financing	0	0	0	68,437	0
Other	18,893	0	0	0	19,827
Total Disbursements	120,929	915	1,295,712	138,280	553,874
Ending Balance, Fiscal Year 2003	51,684	46,591	3,609,073	0	880,766
Receipts:					
Sales tax	134,727	20,133	1,954,981	145,319	618,306
Property tax	0	0	0	0	0
Interest	0	22	84,514	41	22,742
Bond proceeds	0	0	0	0	0
Tax increment financing	0	0	0	0	0
Kansas City Municipal Assistance Corporation	0	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	0	0	0	0	0
Total Receipts	134,727	20,155	2,039,495	145,360	641,048
Disbursements:					
Bond issuance costs	0	0	0	0	0
Professional fees	0	0	0	0	0
Debt service	36,438	0	1,188,825	69,536	515,400
Insurance	0	1,148	0	0	0
Accounting and auditing	0	0	0	0	0
Administrative	36,588	0	18,166	2,438	30,497
City transportation project costs	0	0	0	0	0
Transportation project costs	0	0	0	0	0
Collection fees	0	0	19,556	1,453	0
Tax increment financing	0	0	0	71,933	0
Other	92,560	15	0	0	8,735
Total Disbursements	165,586	1,163	1,226,547	145,360	554,632
Ending Balance, Fiscal Year 2004	$ 20,825	65,583	4,422,021	0	967,182

* Fiscal year 2002 information is for an 18-month period, due to a change in year end.

APPENDIX E

TRANSPORTATION DEVELOPMENT DISTRICTS
SCHEDULE OF RECEIPTS, DISBURSEMENTS, AND CASH BALANCES - SELECTED TDDs

	Platte County Missouri South I & II	Truman Road	Country Club Plaza of Kansas City, Missouri**	Wentzville	Shoppes at Old Webster
Beginning balance, Fiscal Year 2002	$ 12,136	3,471	0	0	0
Receipts:					
Sales tax	33,790	20,782	1,362,581	160,937	2,651
Property tax	0	0	0	0	0
Interest	1,006	21	18,819	22,349	2
Bond proceeds	0	0	12,815,000	3,970,000	0
Tax increment financing	0	0	0	0	0
Kansas City Municipal Assistance Corporation	811,496	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	201,371	0	54	0	0
Total Receipts	1,047,663	20,803	14,196,454	4,153,286	2,653
Disbursements:					
Bond issuance costs	0	0	394,600	211,883	0
Professional fees	0	0	8,168	240,679	0
Debt service	0	0	1,084,186	191,938	0
Insurance	0	0	0	4,040	0
Accounting and auditing	0	0	51,744	0	0
Administrative	0	10,322	0	0	95
City transportation project costs	1,005,310	0	0	0	0
Transportation project costs	0	0	11,149,363	2,117,097	0
Collection fees	0	0	0	1,866	0
Tax increment financing	0	0	10,933	0	0
Other	90	0	3,879	0	0
Total Disbursements	1,005,400	10,322	12,702,873	2,767,503	95
Ending Balance, Fiscal Year 2002	54,399	13,952	1,493,581	1,385,783	2,558
Receipts:					
Sales tax	32,046	9,521	1,175,452	267,663	15,975
Property tax	0	0	0	0	0
Interest	2,448	21	13,612	8,819	19
Bond proceeds	0	0	0	0	0
Tax increment financing	0	0	0	0	0
Kansas City Municipal Assistance Corporation	3,080,828	0	0	0	0
Industrial Development Authority	0	0	0	0	0
Other	0	0	1,827	0	0
Total Receipts	3,115,322	9,542	1,190,891	276,482	15,994
Disbursements:					
Bond issuance costs	0	0	0	0	0
Professional fees	0	0	10,305	45,250	0
Debt service	0	0	1,060,968	234,230	15,900
Insurance	0	0	0	0	0
Accounting and auditing	0	0	46,893	0	0
Administrative	0	8,401	0	0	66
City transportation project costs	2,887,014	0	0	0	0
Transportation project costs	0	0	0	312,545	0
Collection fees	0	0	0	2,677	0
Tax increment financing	0	0	19,497	0	0
Other	170,089	0	13,102	0	0
Total Disbursements	3,057,103	8,401	1,150,765	594,702	15,966
Ending Balance, Fiscal Year 2003	112,618	15,093	1,533,707	1,067,563	2,586
Receipts:					
Sales tax	522,282	7,029	1,250,597	307,299	
Property tax	0	0	0	0	
Interest	5,480	16	16,009	7,550	
Bond proceeds	0	0	0	0	Waiting on TDD
Tax increment financing	0	0	0	0	contact to provide
Kansas City Municipal Assistance Corporation	884,623	0	0	0	financial statement
Industrial Development Authority	13,166,048	0	0	0	
Other	0	0	2,466	0	
Total Receipts	14,578,433	7,045	1,269,072	314,849	0
Disbursements:					
Bond issuance costs	0	0	0	0	
Professional fees	51,429	0	11,142	8,525	
Debt service	420,115	0	1,115,088	234,230	
Insurance	0	0	0	0	
Accounting and auditing	17,691	0	50,824	0	
Administrative	0	3,832	0	0	
City transportation project costs	824,090	0	0	0	
Transportation project costs	13,138,140	0	0	279,355	
Collection fees	0	0	0	3,079	
Tax increment financing	0	0	38,313	0	
Other	548	0	4,040	0	
Total Disbursements	14,452,013	3,832	1,219,407	525,189	0
Ending Balance, Fiscal Year 2004	$ 239,038	18,306	1,583,372	857,223	2,586

** Non-cash items presented on the TDD's financial statements were not presented on this schedule.

TAX FOUNDATION
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BACKGROUND PAPER

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2007 State Business Tax Climate Index

By

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Introduction

The Tax Foundation presents the 2007 version of the State Business Tax Climate Index (SBTCI) as a tool for lawmakers, the media, and individuals alike to gauge how their states' tax systems compare. Policymakers can use the SBTCI to pinpoint changes to their tax systems that will explicitly improve their states' standing in relation to competing states.

American companies often function at a competitive disadvantage in the global economy. They pay one of the highest corporate tax rates of any of the industrialized countries. The top federal rate on corporate income is 35 percent, and states with punitive tax systems cause companies to be even less competitive globally. The modern market is characterized by mobile capital and labor. Therefore, companies will locate where they have the greatest competitive advantage. States with the best tax systems will be the most competitive in attracting new businesses and most effective at generating economic and employment growth.

Although the market is now global, the Department of Labor reports that most mass job relocations are from one U.S. state to another rather than to an overseas location.[1] Certainly job creation is rapid overseas, as previously underdeveloped nations enter the world economy. So state lawmakers are right to be concerned about how their states rank in the global competition for jobs and capital, but they need to be more concerned with companies moving from Indianapolis, IN to Ithaca, NY, rather than from Indianapolis to India. This means that state lawmakers must be aware of how their states' business climates match up to their immediate neighbors and to other states within their regions.

Examples of companies choosing states due to favorable tax systems are plentiful. A recent example, from 2005, is Intel's decision to build a multi-billion dollar chip-making facility in Arizona due to its favorable corporate income tax system. California struggles to retain businesses within its borders because Nevada provides a low-tax alternative. Anecdotes such as

[1] U.S. Department of Labor, "Extended Mass Layoffs in the First Quarter of 2006," May 11, 2006, located at http://www.bls.gov/news.release/mslo.nr0.htm. In the press release, DOL reported that: "In the 50 actions where employers were able to provide more complete separations information, 80 percent of relocations (40 out of 50) occurred among establishments within the same company. In 56 percent of these relocations, the work activities were reassigned to places elsewhere in the U.S. Forty-four percent of the movement-of-work relocations involved out-of-country moves (22 out of 50)." (internal references omitted).

The authors would like to thank several people outside the Tax Foundation for their collaboration. J. Scott Moody, Vice President, Maine Heritage Policy Center and Wendy P. Warcholik, Ph.D were co-authors of previous editions. Other helpful commentary came from Tom Armstrong, Associate Director for Strategic Data Analysis & Reporting, Pennsylvania State System of Higher Education; Douglas Lindholm, President, Council on State Taxation (COST); Joe Crosby, Legislative Director at COST; and Art Rosen, Partner, McDermott Will & Emery.

Here at the Foundation, the entire team of economists contributes to the Index. President Scott Hodge was co-author of earlier editions, and research assistant Johanna L. Mausolf was indispensible. Editors William Ahern and Alicia Hansen have made substantive and stylistic improvements to each of the four annual editions of the State Business Tax Climate Index.

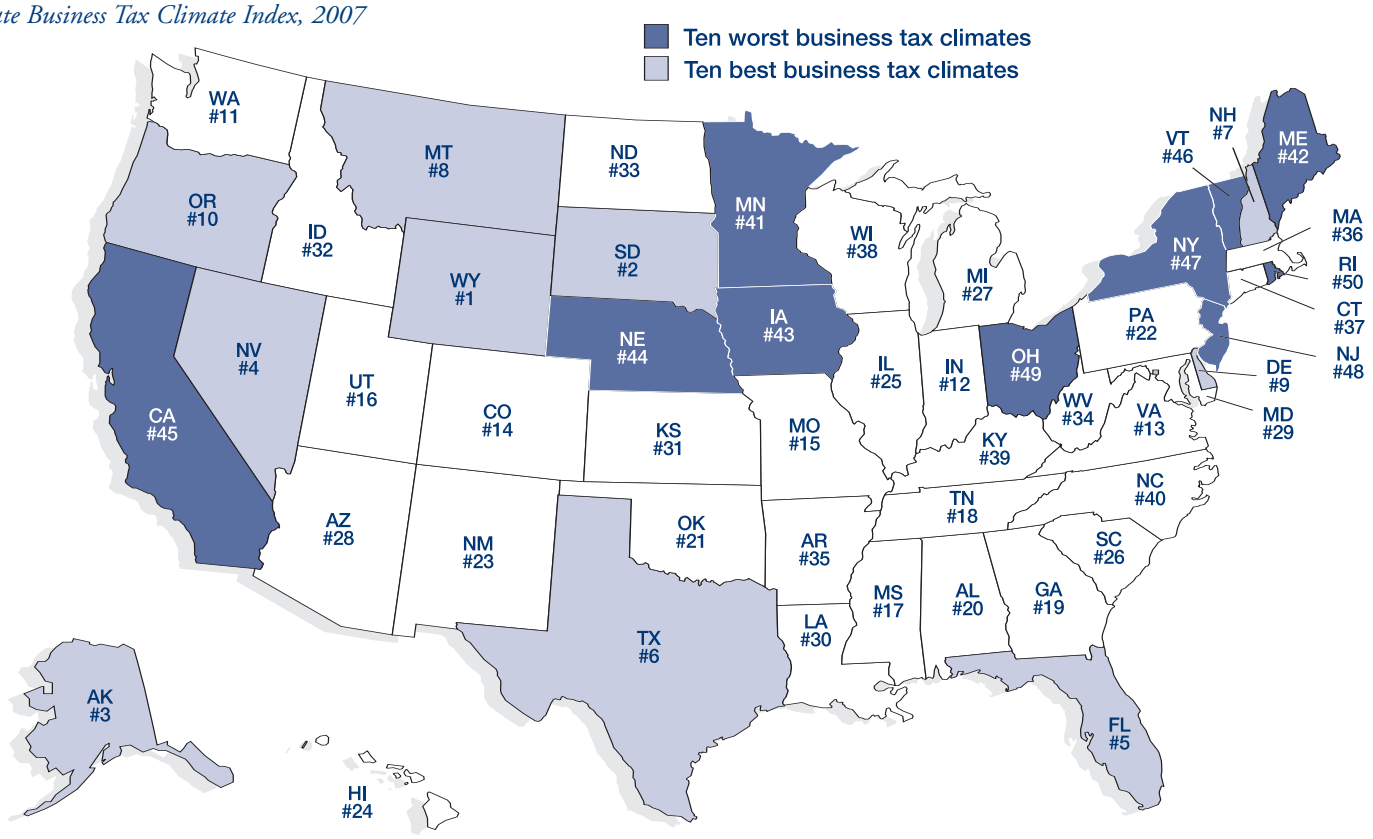
these reinforce what we know from economic theory: taxes matter to businesses, and those places with the most competitive tax systems will reap the benefits of business-friendly tax climates.

A recent report from the Rockefeller Institute said that state tax revenues were 8.9 percent higher in the first quarter of 2006 than during the same period a year earlier.[2] This continues a trend of surging state revenues that Rockefeller traces back to the latter half of 2003.[3] A return to budget surpluses offers many state lawmakers the opportunity to reform their tax codes in order to make their states more attractive to domestic and foreign investment. Indeed, this is why many states have created tax reform commissions to study pro-competitive tax reform.[4]

State lawmakers are always mindful of their states' business tax climates but they are often tempted to lure business with lucrative tax incentives and subsidies instead of broad-based tax reform. This can be a dangerous proposition, as a case in Florida illustrates. In July of 2004 Florida lawmakers cried foul because a major credit card company announced it would close its Tampa call center, lay off 1,110 workers, and outsource those jobs to another company. The reason for the lawmakers' ire was that the company had been lured to Florida with a generous tax incentive package and had enjoyed nearly $3 million worth of tax breaks during the past nine years.[5]

Lawmakers create these deals under the banner of job creation and economic development, but the truth is that if a state needs to offer such packages, it is most likely covering for a woeful business tax climate. A far more effective approach is to systematically improve the business tax climate for the long term so as to improve the state's competitiveness. When assessing which changes to make, lawmakers need to remember these two rules:

Figure 1
State Business Tax Climate Index, 2007



[2] Brian T. Stenson and Nai-Ling Kuo, "State Tax Revenue Rebounds on Strength in South and West," *State Revenue Report No. 64* (June 2006) located at http://rfs.rockinst.org/exhibit/9058/Full%20Text/RR_64.pdf.

[3] *Id. at Table 1.*

[4] Lawmakers in at least 7 states—Georgia, Indiana, Michigan, Missouri, Nebraska, Oklahoma, and West Virginia—have recently created tax reform study commissions or held prominent meetings to discuss tax reform.

[5] Dave Wasson, "Florida Lawmakers Slam Capital One's Layoff After Years of Tax Breaks," Tax Analysts, July 27. 2004.

Table 1
State Business Tax Climate Index, 2003, 2004, 2006 and 2007

	FY 2007 State Business Tax Climate Index		FY 2006 State Business Tax Climate Index		Change from 2006 to 2007		CY 2004 State Business Tax Climate Index		CY 2003 State Business Tax Climate Index	
State	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
U.S.	5.00	-	5.00	-			5.00	-	5.00	-
Alabama	5.47	20	5.60	16	– 0.13	– 4	5.53	17	5.52	17
Alaska	7.23	3	7.29	3	– 0.06	0	7.31	3	7.30	3
Arizona	5.14	28	5.13	29	0.01	1	5.06	31	5.12	27
Arkansas	4.88	35	4.87	35	0.02	0	4.85	35	4.98	31
California	4.51	45	4.64	42	– 0.13	– 3	4.75	38	4.67	43
Colorado	5.67	14	5.70	13	– 0.03	– 1	5.68	12	5.73	12
Connecticut	4.83	37	4.66	41	0.17	4	4.73	39	4.77	37
Delaware	6.08	9	6.10	9	– 0.02	0	6.05	8	5.98	11
Florida	6.86	5	6.85	5	0.01	0	6.85	5	6.88	5
Georgia	5.48	19	5.52	20	– 0.04	1	5.51	18	5.48	19
Hawaii	5.24	24	5.28	24	– 0.04	0	5.29	25	5.18	25
Idaho	5.03	32	5.08	30	– 0.05	– 2	5.08	30	5.07	30
Illinois	5.23	25	5.22	26	0.01	1	5.32	23	5.47	20
Indiana	5.79	12	5.86	12	– 0.07	0	6.00	11	6.02	10
Iowa	4.56	43	4.62	44	– 0.07	1	4.62	44	4.54	46
Kansas	5.04	31	4.99	33	0.05	2	4.95	32	4.97	32
Kentucky	4.76	39	4.75	38	0.01	– 1	5.10	29	4.95	33
Louisiana	5.04	30	5.05	32	– 0.01	2	4.85	36	4.86	35
Maine	4.67	42	4.64	43	0.03	1	4.71	40	4.73	40
Maryland	5.13	29	5.23	25	– 0.11	– 4	5.45	20	5.46	21
Massachusetts	4.88	36	4.87	36	0.01	0	4.92	33	5.08	29
Michigan	5.15	27	5.20	28	– 0.06	1	5.22	27	5.18	26
Minnesota	4.68	41	4.71	39	– 0.03	– 2	4.68	41	4.61	45
Mississippi	5.57	17	5.57	19	0.00	2	5.44	21	5.45	22
Missouri	5.65	15	5.68	14	– 0.03	– 1	5.67	14	5.55	16
Montana	6.20	8	6.16	8	0.04	0	5.66	15	5.65	14
Nebraska	4.53	44	4.59	45	– 0.06	1	4.61	45	4.73	41
Nevada	7.12	4	7.07	4	0.05	0	7.08	4	7.23	4
New Hampshire	6.21	7	6.45	6	– 0.23	– 1	6.34	7	6.28	7
New Jersey	3.92	48	3.63	48	0.29	0	4.22	47	4.25	48
New Mexico	5.31	23	5.30	23	0.01	0	5.13	28	4.91	34
New York	4.16	47	3.60	49	0.55	2	3.41	50	3.64	49
North Carolina	4.72	40	4.70	40	0.02	0	4.63	43	4.66	44
North Dakota	4.98	33	5.06	31	– 0.08	– 2	4.81	37	4.76	39
Ohio	3.82	49	3.82	47	0.00	– 2	4.17	48	4.34	47
Oklahoma	5.45	21	5.41	21	0.04	0	5.40	22	5.41	23
Oregon	6.04	10	6.02	10	0.01	0	6.04	9	6.11	8
Pennsylvania	5.36	22	5.31	22	0.05	0	5.29	24	5.12	28
Rhode Island	3.47	50	3.47	50	0.00	0	3.51	49	3.53	50
South Carolina	5.22	26	5.21	27	0.01	1	5.23	26	5.20	24
South Dakota	7.57	2	7.56	2	0.01	0	7.56	2	7.49	2
Tennessee	5.49	18	5.58	18	– 0.09	0	5.46	19	5.51	18
Texas	6.45	6	6.41	7	0.04	1	6.38	6	6.38	6
Utah	5.63	16	5.67	15	– 0.03	– 1	5.67	13	5.58	15
Vermont	4.42	46	4.57	46	– 0.14	0	4.56	46	4.70	42
Virginia	5.68	13	5.58	17	0.10	4	5.64	16	5.71	13
Washington	5.95	11	5.93	11	0.02	0	6.01	10	6.08	9
West Virginia	4.92	34	4.93	34	– 0.01	0	4.89	34	4.76	38
Wisconsin	4.78	38	4.77	37	0.01	– 1	4.67	42	4.84	36
Wyoming	7.66	1	7.64	1	0.02	0	7.60	1	7.58	1
District of Columbia	4.06	-	4.41	-	– 0.35	-	4.46	-	4.03	-

Note: The higher the score the better, the more favorable a state's tax system is for business.
Scores from 2003 and 2004 are calendar year, 2006 and 2007 are fiscal year.
Source: Tax Foundation

1. Taxes matter to business. Business taxes affect business decisions, job creation and retention, plant location, competitiveness, the transparency of the tax system, and the long-term health of a state's economy. Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (through higher prices), workers (through lower wages or fewer jobs), or shareholders (through lower dividends or share value). Thus a state with lower tax costs will be more attractive to business investment.

2. States do not enact tax changes (increases or cuts) in a vacuum. Every tax law will in some way

change a state's competitive position relative to its immediate neighbors, its geographic region, and even globally. Ultimately it will affect the state's national standing as a place to live and to do business. Entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

Clearly, there are many non-tax factors that affect a state's overall business climate: its proximity to raw materials or transportation centers, its regulatory or legal structures, the quality of its education system and the skill of its workforce, not to mention the intangible perception of a state's "quality of life."[6] The 2007 SBTCI does not measure the impact of these important features of a state's overall business climate. Rather, the SBTCI merely seeks to measure the tax component of each state's business climate.

Some of the non-tax factors of a state's business climate are outside of the control of elected officials. Montana lawmakers cannot change the fact that Montana's businesses have no immediate access to deepwater ports. Lawmakers do, however, have direct control over how friendly their tax systems are to business. Furthermore, unlike changes to a state's health care, transportation, or education system—which can take decades to implement—changes to the tax code bring almost instantaneous benefits to a state's business climate.

The ideal tax system—whether at the local, state or federal level—is simple, transparent, stable, neutral to business activity, and pro-growth. In such an ideal system, individuals and businesses would spend a minimum amount of resources to comply with the tax system, understand the true cost of the tax system, base their economic decisions solely on the merits of the transactions, without regard to tax implications, and not have the tax system impede their growth and prosperity.

In reality, tax-induced economic distortions are a fact of life, and a more realistic goal is to maximize the occasions when businesses and individuals are guided by business principles, and minimize those cases where economic decisions are micromanaged or even dictated by a tax system. Therefore, the most competitive tax systems, and the ones that score best in the SBTCI, are those that create the fewest economic distortions by enforcing the most simple, pro-growth tax systems characterized by broad bases and low rates.

The SBTCI does not measure business tax burdens. While it is unquestionably important how much revenue states collect in business taxes, the manner in which they extract tax revenue is also important. In other words, quite apart from whether a state's total business tax burden is higher than in other states, it can enact (and many states do) a set of business tax laws that cause great damage to the economy. The SBTCI does not allow states with poor business tax regimes to hide behind low business tax burdens.

Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with politically motivated preferences the less likely it is that business decisions will be made in response to market forces. The SBTCI rewards those states that apply these principles in five important areas of taxation: major business taxes, individual income taxes, sales taxes, unemployment insurance taxes and property taxes.

Tax competition is an unpleasant reality for state revenue and budget officials, but it is an effective restraint on state and local taxes. It also helps to more efficiently allocate resources because businesses can locate in the states where they receive the services they need at the lowest cost. When a state imposes higher taxes than a neighboring state, businesses will cross the border to some extent. Therefore states with more competitive tax systems score well in the SBTCI because they are best suited to generate economic growth.

Ranking the competitiveness of 50 very different tax systems presents many challenges, especially when a state dispenses with a major tax entirely. Should Colorado's tax system, which includes three

[6] A trend in tax literature throughout the 1990s has been the increasing use of indexes to measure a state's general business climate. These include the Center for Policy and Legal Studies' "Economic Freedom in America's 50 States: A 1999 Analysis" and the Beacon Hill Institute's "State Competitiveness Report 2001." Such indexes even exist on the international level, including the Heritage Foundation and Wall Street Journal's "2004 Index of Economic Freedom." Plaut and Pluta (1983) examined the use of business climate indexes as explanatory variables for business location movements. They found that such general indexes do have a significant explanatory power helping to explain, for example, why businesses have moved from the Northeast and Midwest towards the South and Southwest. In turn, they also found that high taxes have a negative effect on employment growth.

[7] Rhode Island lawmakers recently passed an optional flat tax on individual income with an 8 percent rate for 2006 (scheduled to decrease to 5.5 percent by 2011). Filers can calculate their liabilities under both laws—the old rates and brackets and the new flat tax—and pay the lower amount. While this development may well improve Rhode Island's business tax climate, especially if the current schedule of gradually lower flat tax rates is kept, the SBTCI does not take this unusual, optional tax law into account.

relatively neutral taxes on general sales, individual income and corporate income, be considered more or less competitive than Alaska's tax system, which includes a particularly burdensome corporate income tax but no tax on individual income or general statewide sales tax?

The 2007 SBTCI deals with such questions by comparing the states on five separate aspects of their tax systems and then adding the results up to a final, overall ranking. This approach has the advantage of rewarding states on particularly strong aspects of their tax systems (or penalizing them on particularly weak aspects) while also measuring the general competitiveness of their overall tax systems. The result is a score that can be compared to other states' scores. Ultimately, both Alaska and Colorado score well.

This edition is the 2007 SBTCI and represents the tax climate of each state as of July 1, 2006, the first day of the standard 2007 fiscal year.

The Best and Worst Business Tax Climates

The ten best states in the Tax Foundation's 2007 State Business Tax Climate Index are as follows:

1. Wyoming
2. South Dakota
3. Alaska
4. Nevada
5. Florida
6. Texas
7. New Hampshire
8. Montana
9. Delaware
10. Oregon

It is obvious that the absence of a major tax is a dominant factor in vaulting these ten states to the top of the rankings. Property taxes and unemployment insurance taxes are levied in every state, but there are several states that do without either a corporate tax, an individual income tax, or a sales tax. Wyoming, Nevada and South Dakota have no corporate or individual income tax; Alaska has no individual income or state-level sales tax; Florida and Texas have no individual income tax; and New Hampshire, Delaware, Oregon and Montana have no sales tax. The lesson is simple; a state that raises sufficient revenue without one of the major taxes will, all things being equal, out-compete those states that levy every tax in the state tax collector's arsenal.

The ten worst states in the SBTCI are as follows:

41. Minnesota
42. Maine
43. Iowa
44. Nebraska
45. California
46. Vermont
47. New York
48. New Jersey
49. Ohio
50. Rhode Island

Rhode Island has the worst unemployment tax system, the worst property tax system, and the third worst individual income tax system.[7] Ohio has the fourth worst property tax system and second worst individual income tax system. New Jersey has the worst individual income tax system and the fifth worst property tax system. New York has the second worst sales tax system and the fifth worst unemployment tax system. The remaining states in the bottom ten suffer from the same afflictions that plague these four bottom states: complex, non-neutral taxes with comparatively high rates.

A detailed description of each component index, each sub-index, and their various components is presented later in the paper, and those states that score especially well or poorly on each component are discussed to provide guidance on the changes that each state might well contemplate.

A Review of the Economic Literature

Economists have not always agreed on how individuals and businesses react to taxes. As early as 1956, Charles Tiebout postulated that if citizens were faced with an array of communities that offered different types or levels of public goods and services at different costs or tax levels, then all citizens would choose the community that best satisfied their particular demands, revealing their preferences by "voting with their feet." Tiebout's article is the seminal work on the topic of taxation affecting the location decisions of taxpayers.

Tiebout also suggested that citizens with high demands for public goods would concentrate themselves in communities with high levels of public services and high taxes while those with low demands would choose communities with low levels of public services and low taxes. Competition among jurisdictions results in a variety of communities, each with residents that all value public services similarly.

However, businesses sort out the costs and benefits of taxes differently from individuals. To busi-

nesses, which can be more mobile and must earn profits to justify their existence, taxes reduce profitability. Theoretically, then, businesses could be expected to be more responsive than individuals to the lure of low-tax jurisdictions.

The economic literature over the past 50 years has slowly cohered around this hypothesis. Ladd (1998) summarizes the post-World War II empirical tax research literature in an excellent survey article, breaking it down into three distinct periods of differing ideas about taxation: (1) taxes do not change behavior; (2) taxes may or may not change business behavior depending on the circumstances; (3) taxes definitely change behavior.

Arizona

Arizona ranks 28th overall, largely because its sales tax system is dragging down what is otherwise an above-average tax system in almost every respect. A major culprit is high local rates. Nineteen states don't even permit local governments to levy their own sales taxes, and only a handful has let local rates rise to the level that Arizona has. As for its state-level sales tax of 5.6%, which is above average, Arizona applies it to many business-to-business transactions, which causes tax pyramiding.

Period one, with the exception of Tiebout, included the 1950s, '60s and '70s and is summarized succinctly in three survey articles: Due (1961), Oakland (1978) and Wasylenko (1981). Due's was a polemic against tax giveaways to businesses, and his simple analysis techniques consisted of basic correlations, interview studies and the examination of taxes relative to other costs. He found no evidence to support the notion that taxes influence business location.

Oakland was skeptical of the assertion that tax differentials at the local level had no influence at all. However, because econometric analysis was relatively unsophisticated at the time, he found no significant articles to support his intuition. Wasylenko's survey of the literature found some of the first evidence indicating that taxes do influence business location decisions. However, the statistical significance was lower than that of other factors such as labor supply and agglomeration economies. Therefore, he dismissed taxes as a secondary factor at most.

Period two was a brief transition during the early- to mid-1980s. This was a time of great ferment in tax policy as Congress passed major tax bills, including the so-called Reagan tax cut in 1981 and a dramatic reform of the tax code in 1986. Articles revealing the economic significance of tax policy proliferated and became more sophisticated. For example, Wasylenko and McGuire (1985) extended the traditional business location literature to non-manufacturing sectors and found, "Higher wages, utility prices, personal income tax rates, and an increase in the overall level of taxation discourage employment growth in several industries." However, Newman and Sullivan (1988) still found a mixed bag in "their observation that significant tax effects [only] emerged when models were carefully specified." (Ladd, p. 89).

Ladd was writing in 1998, so her "period three" started in the late 1980s and continued up to 1998 when the quantity and quality of articles increased significantly. Articles that fit into period three begin to surface as early as 1985, as Helms (1985) and Bartik (1985) put forth forceful arguments based on empirical research that taxes guide business decisions. Helms concluded that a state's ability to attract, retain, and encourage business activity is significantly affected by its pattern of taxation. Furthermore, tax increases significantly retard economic growth when the revenue is used to fund transfer payments. Bartik found that the conventional view, as he describes it, that state and local taxes have little effect on business is false.

Papke and Papke (1986) found that tax differentials between locations may be an important business location factor, finding that consistently high business taxes can represent a hindrance to the location of industry. Interestingly, they use the same type of after-tax model used by Tannenwald (1996), but he reaches a different conclusion.

Bartik (1989) provides strong evidence that taxes negatively impact business start-ups. He finds specifically that property taxes, because they are paid regardless of profit, have the strongest negative effect on business. Bartik's econometric model also predicts that tax elasticities of -.1 to -.5 imply that a ten percent cut in tax rates will increase business activity by 1 to 5 percent. Bartik's findings, as well as those of Mark, McGuire, and Papke (2000), about property taxes buttress the argument, in addition to ample anecdotal evidence of the importance of property taxes, for inclusion of a property index devoted to property-type taxes in the SBTCI.

By the early 1990s, the literature expanded enough so that Bartik (1991) found 57 studies on which to base his literature survey. Ladd succinctly summarizes Bartik's findings:

> The large number of studies permitted Bartik to take a different approach from the other authors. Instead of dwelling on the results and limitations of each individual study, he looked at them in the aggregate and in groups. Although he acknowledged potential criticisms of individual studies, he convincingly argued that some systematic flaw would have to cut across all studies for the consensus results to be invalid. In striking contrast to previous reviewers, he concluded that taxes have quite large and significant effects on business activity (p. 92).

Ladd's "period three" surely continues to this day. Agostini and Tulayasathien (2001) examined the effects of corporate income taxes on the location of foreign direct investment in U.S. states. They determined that for "foreign investors, the corporate tax rate is the most relevant tax in their investment decision." Therefore, they found that foreign direct investment was quite sensitive to states' corporate tax rates (p. 28).

Mark, McGuire, and Papke (2000) find that taxes are a statistically significant factor in private sector job growth. Specifically, they find that personal property taxes and sales taxes have economically large negative effects on the annual growth of private employment (Mark, et al. 2000).

Harden and Hoyt (2003) point to Phillips and Gross (1995) as another study contending that taxes impact state economic growth, and they assert that the consensus among recent literature is that state and local taxes negatively affect employment levels. Harden and Hoyt conclude that the corporate income tax has the most significant negative impact on the rate of growth in employment.

Gupta and Hofmann (2003) regressed capital expenditures against a variety of factors including weights of apportionment formulas, the number of tax incentives and burden figures. Their model covered 14 years of data and determined that firms tend to locate property in states where they are subject to lower income tax burdens. Furthermore, Gupta and Hofmann suggest that throwback requirements are most influential on the location of capital investment, followed by apportionment weights and tax rates, and that investment-related incentives have the least impact.

Other economists have found that taxes on specific products can produce behavioral results similar to those that were found in these general studies. For example, Fleenor (1998) looked at the effect of excise tax differentials between states on cross-border shopping and the smuggling of cigarettes. Moody and Warcholik (2004) examined the cross-border effects of beer excises. Their results, supported by the literature in both cases, showed significant cross-border shopping and smuggling between low-tax states and high-tax states.

Fleenor found that shopping areas sprouted in counties of low-tax states that shared a border with a high-tax state, and that approximately 13.3 percent of the cigarettes consumed in the United States during FY 1997 were procured via some type of cross-border activity. Similarly, Moody and Warcholik found that in 2000, 19.9 million cases of beer, on net, moved from low- to high-tax states. This amounted to some $40 million in sales and excise tax revenue lost in high-tax states.

Even though the general tide of the literature has progressed to the point where the consensus is that taxes are a substantial factor in the decision-making process for businesses, there remain some authors who are not convinced.

Based on a substantial review of the literature on business climates and taxes, Wasylenko (1997) concludes that taxes do not appear to have a substantial effect on economic activity among states. He does, however, cite a *State Policy Report* article that asserts the opposite: that as long as the tax elasticity is negative and significantly different from zero, high-tax states will lose more economic activity than average or low-tax states. Indeed, *State Policy Report* continues, the highest-tax states, such as Minnesota, Wisconsin, and New York, have acknowledged that high taxes may be responsible for the low rates of job creation in those states.[8]

Wasylenko's rejoinder is that policymakers routinely overestimate the degree to which tax policy affects business location decisions, and that as a result of this misperception, they respond readily to public pressure for jobs and economic growth by proposing lower taxes. According to Wasylenko, other legislative actions are likely to accomplish more positive economic results because in reality, taxes do not drive economic growth. He asserts that lawmakers need better advice than just "Lower your taxes," but there is no coherent message advocating a different course of action.

Carroll and Wasylenko (2004) argue that a structural change occurred during the 1980s, at which time a state's business climate became unimportant to its ability to grow economically. They contend that international competition essentially has made competition between states obsolete:

> State factors may have become less important relative to differentials that exist between the locations within the United States and those abroad. The rapid rise in imports and in foreign investment in the United States has radically changed the structure of the domestic economy (Carroll and Wasylenko 2004).

This surprising conclusion contradicts ample evidence that states certainly still compete for businesses using their tax systems. A recent example is that of Intel, an international firm that was enticed to

[8] *State Policy Reports.* 1994, Vol. 12, No. 11 (June), Issue 1 of 2, p.9.

build a plant in Arizona. From the *San Jose Mercury News:*

> Wooed by tax incentives and a skilled manufacturing workforce, Intel will spend $3 billion to build a next-generation chip factory in Chandler, Arizona. "California has been, in the last 10 to 15 years, pretty expensive," said Chuck Mulloy, an Intel spokesman. "There aren't the kind of incentives that were available in Arizona or other locations to offset the capital investment to put a factory like this in place. They just don't have any packages or programs to encourage companies to build any new manufacturing, of any kind."[9]

What in fact brought Intel to Arizona was not the type of special package or program targeted at just one firm. Arizona enacted a change in its apportionment formula from a 50 percent sales and 25 percent property and payroll apportionment formula to an 80 percent sales formula by 2009. Furthermore, according to the Labor Department, the majority of business relocations are from state to state.

In sum, Carroll and Wasylenko's findings are contradicted by economic theory and ample anecdotal and empirical evidence.

Metrics to Measure the Impact of Tax Differentials

Some recent contributions to the literature on state taxation criticize business and tax climate studies in general. Authors of such studies contend that indexes like the State Business Tax Climate Index do not take into account those factors which directly impact a state's business climate. However, a careful examination of these criticisms reveals that the authors believe taxes are unimportant to businesses and therefore dismiss the studies as merely being designed to advocate low taxes.

Peter Fisher's *Grading Places: What Do the Business Climate Rankings Really Tell Us?*, published by the Economic Policy Institute, criticizes five indexes: The Small Business Survival Index published by the Small Business and Entrepreneurship Council, Beacon Hill's Competitiveness Reports, the Cato Institute's Fiscal Policy Report Card, the Economic Freedom Index by the Pacific Research Institute, and the 2003 edition of this study. Fisher concludes: "The underlying problem with the five indexes, of course, is twofold: none of them actually do a very good job of measuring what it is they claim to measure, and they do not, for the most part, set out to measure the right things to begin with" (Fisher 2005). Fisher's major argument is that if the indexes did what they purported to do, then all five of them would rank the states similarly.

Fisher's conclusion holds little weight because the five indexes serve such dissimilar purposes and each group has a different area of expertise. There is no reason to believe that the Tax Foundation's Index, which depends entirely on state tax laws, would rank the states in the same or similar order as an index that includes crime rates, electricity costs and health care (Small Business and Entrepreneurship Council's Small Business Survival Index), or infant mortality rates, air passengers per capita and the percentage of adults in the workforce (Beacon Hill's State Competitiveness Report), or charter schools, tort reform and minimum wage laws (Pacific Research Institute's Economic Freedom Index).

The Tax Foundation's State Business Tax Climate Index is an indicator of which states' tax systems are the most hospitable to business and economic growth. The SBTCI does not attempt to measure economic opportunity or freedom, or even the broad business climate, but the narrower business tax climate. We do so not only because the Tax Foundation's expertise is in taxes, but because every component of the SBTCI is subject to immediate change by state lawmakers. It is by no means clear what the best course of action is for state lawmakers who want to thwart crime, for example, either in the short or long term, but they can change their tax codes now. The Tax Foundation believes business decisions are significantly impacted by tax considerations, but Fisher takes the contrarian 1970s view that the effects of taxes are "small or non-existent."

Although Fisher does not feel tax climates are important to states' economic growth, other authors contend the opposite. Bittlingmayer, Eathington, Hall and Orazem (2005) find in their analysis of several business climate studies that a state's tax climate does affect its economic growth rate, and that several indexes are able to predict growth. In fact, they found, "The State Business Tax Climate Index explains growth consistently." This finding was recently confirmed by Anderson (2006) in a study for the Michigan House of Representatives.

Bittlingmayer, et al, also found that relative tax competitiveness matters, especially at the borders, and therefore, indexes that place a high premium on tax policies better explain growth. Also, they observed that studies focused on a single topic do better at explaining economic growth at borders. Lastly, the article concludes that the most important

[9] Therese Poletti, "Incentive-Rich Arizona to House New Intel Plant," *San Jose Mercury News,* July 26, 2005.

elements of the business climate are tax and regulatory burdens on business (Bittlingmayer et al. 2005). These findings support the argument that taxes impact business decisions and economic growth, and they support the validity of the SBTCI.

Fisher and Bittlingmayer et al. hold opposing views about the impact of taxes on economic growth. Fisher finds support from Robert Tannenwald of the Boston Federal Reserve, who argues that taxes are not as important to businesses as public expenditures. Tannenwald compares 22 states by measuring the after-tax rate of return to cash flow of a new facility built by a representative firm in each state. This very different approach attempts to compute the marginal effective tax rate (METR) of a hypothetical firm and yields results that make taxes appear trivial.

Tannenwald asserts that "while interjurisdictional rivalry is inducing states to cut taxes, demand is rising for state and local services such as education, health care, and law enforcement." He concludes that business taxes exert only a small, highly uncertain effect on capital spending. States may be more likely to stimulate their economy by enhancing public services valued by business (Tannenwald 1996).

The taxes paid by businesses should be a concern to everyone because they are ultimately borne by individuals through lower wages, increased prices, and decreased shareholder value. States do not institute tax policy in a vacuum. Every change to a state's tax system makes its business tax climate more or less competitive compared to other states, and makes the state more or less attractive to business. Ultimately, anecdotal and empirical evidence, along with the cohesion of recent literature around the conclusion that taxes matter a great deal to business, show that the SBTCI is an important and useful tool for policymakers who want to make their states' tax systems welcoming to business.

Methodology

The Tax Foundation's 2007 State Business Tax Climate Index is a hierarchical structure built from five component indexes:

- The Corporate Tax Index
- The Individual Income Tax Index
- The Sales Tax Index
- The Unemployment Tax Index
- The Property Tax Index

Using the economic literature as our guide, we designed these five component indexes to score each state's business tax climate on a scale of zero (worst) to 10 (best). Each component index is devoted to a major area of state taxation and each has two equally weighted sub-indexes, some of which include several categories and variables under them. Overall, there are 10 sub-indexes and 113 variables. The ranking of the states on each of the five major component indexes is presented in Table 2.

The five component indexes are not weighted equally, as they are in many indexes. Rather, each component index is weighted based on the variability of the 50 states' scores from the mean. The standard deviation of each component index is calculated and a weight for each component index is created from that measure. The result is a heavier weighting of those component indexes with greater variability.

This improves the explanatory power of the SBTCI because component indexes with higher standard deviations are those areas of tax law where some states have significant competitive advantages. Businesses that are comparing states for new or expanded locations must give greater emphasis to tax climates when the differences are large. On the other hand, component indexes in which the 50 state scores are clustered together, closely distributed around the mean, are those areas of tax law where businesses are more likely to de-emphasize tax factors in their location decisions.

For example, Delaware is known to have a significant advantage in sales tax competition because its zero-rate attracts businesses and shoppers from all over the mid-Atlantic region. That advantage and its drawing power increase every time a state in the region raises its sales tax. In contrast with this sales tax variability, unemployment insurance taxes are comparatively more similar around the nation. Therefore, the 50 scores on this component index are centered tightly around the mean, offering less competitive advantage from state to state. A ranking of these taxes has less importance, then, because a small change in one state's law could change its component index ranking dramatically, but at the same time tell businesses very little about the overall differential between states. The weights are as follows:

1. **29.15%** —Individual Income Tax Index
2. **21.50%** —Sales Tax Index
3. **19.43%** —Corporate Tax Index
4. **15.72%** —Property Tax Index
5. **14.20%** —Unemployment Insurance Tax Index

Table 2
Major Components of the State Business Tax Climate Index, 2007

State	Overall Rank	Corporate Tax Index Rank	Individual Income Tax Index Rank	Sales Tax Index Rank	Unemployment Insurance Tax Index Rank	Property Index Rank
Alabama	20	21	20	21	8	15
Alaska	3	27	6	3	45	17
Arizona	28	24	29	43	10	12
Arkansas	35	36	30	38	35	9
California	45	40	46	39	18	16
Colorado	14	15	14	28	23	18
Connecticut	37	28	19	33	16	49
Delaware	9	48	33	2	9	5
Florida	5	14	1	17	3	31
Georgia	19	6	22	7	32	23
Hawaii	24	9	40	26	24	6
Idaho	32	19	31	36	47	3
Illinois	25	30	13	32	36	40
Indiana	12	22	11	13	17	29
Iowa	43	46	45	19	27	33
Kansas	31	38	23	25	12	34
Kentucky	39	43	39	11	48	11
Louisiana	30	18	27	45	11	25
Maine	42	44	36	14	42	39
Maryland	29	7	35	8	30	41
Massachusetts	36	47	15	10	49	43
Michigan	27	50	12	15	41	35
Minnesota	41	45	37	40	39	14
Mississippi	17	8	16	37	2	21
Missouri	15	10	24	12	7	10
Montana	8	16	21	5	21	24
Nebraska	44	34	32	44	26	45
Nevada	4	1	1	47	40	13
New Hampshire	7	49	9	1	44	32
New Jersey	48	41	50	29	25	46
New Mexico	23	37	18	46	15	1
New York	47	23	38	49	46	42
North Carolina	40	25	43	42	4	38
North Dakota	33	29	44	22	38	4
Ohio	49	39	49	41	19	47
Oklahoma	21	13	25	34	1	20
Oregon	10	20	34	4	29	8
Pennsylvania	22	42	10	23	13	44
Rhode Island	50	35	48	35	50	50
South Carolina	26	11	26	9	43	28
South Dakota	2	1	1	30	31	7
Tennessee	18	12	8	48	33	37
Texas	6	17	7	31	6	36
Utah	16	4	28	24	20	2
Vermont	46	31	47	16	5	48
Virginia	13	5	17	6	22	26
Washington	11	33	1	50	37	27
West Virginia	34	26	41	20	34	19
Wisconsin	38	32	42	27	28	30
Wyoming	1	1	1	18	14	22

Note: Rankings do not average across to total. States without a given tax rank equally as number 1.
Source: Tax Foundation

Within each component index are two sub-indexes devoted to measuring the impact of the tax rates and the tax base. These are weighted equally, 50 percent each.

Each sub-index is composed of one or more variables. There are two types of variables: scalar variables and dummy variables. A scalar variable is one that can have any value between 0 and 10. If a sub-index is composed only of scalar variables, then they are weighted equally.

A dummy variable is one that has only a value of 0 or 1. For example, a state either indexes its brackets for inflation or does not. Mixing scalar and dummy variables within a sub-index is problematic because the extreme valuation of a dummy can overly influence the results of the sub-index. To counter this effect, the Index weights scalar variables 80 percent and dummy variables 20 percent.

RELATIVE VERSUS ABSOLUTE INDEXING

The 2007 State Business Tax Climate Index is designed as a *relative* index rather than an *absolute* or *ideal* index. In other words, each variable is ranked relative to the variable's range in other states. The relative scoring scale is from 0 to 10, with zero meaning not "worst possible" but rather worst among the 50 states.

For example the top rate for individual income taxation ranges from the lowest tax rate, 0.80 percent in New Hampshire[10] to the highest tax rate, 10.3 percent in California. New Hampshire therefore scores 10 in this sub-index, and California scores zero. All the other states that tax income range between these. Near to California is Iowa, with its top rate of 8.98 percent, yielding a low score of 1.28 in this sub-index. Near to New Hampshire is Michigan, with its top tax rate of 3.99 percent,[11] scoring 6.13 in this sub-index. Mississippi and Connecticut fall right in the middle with their 5 percent rates.

Many states' tax rates are so close to each other that an absolute index would not provide enough information about the differences between the states' tax systems, especially to pragmatic business owners who want to know what states have the best tax system in each region.

Comparing States without a Tax

One problem associated with a relative scale, however, is that it is mathematically impossible to compare states with a given tax to states that do not have the tax. Clearly a zero rate is the lowest possible rate and the most neutral base, since it creates the most favorable tax climate for economic growth. The states that have a zero rate on individual income, corporate income or sales gain an immense competitive advantage. Therefore, states without a given tax receive a 10, and the Index measures all the other states against each other.

Normalizing Final Scores

Another problem with using a relative scale within the component indexes is that the average scores

across the five component indexes vary. This alters the value of not having a given tax across major indexes. For example, the unadjusted average score of the Corporate Tax Index is 7.18 while the average score of the Individual Income Tax Index is 5.70.

In order to solve this problem, scores on the five major component indexes are "normalized," which brings the average score for all of them to 5.00—excluding states that do not have the given tax. This is accomplished by multiplying every state's score by a constant value.

Once the scores are normalized it is possible to compare states across indexes. For example, because of normalization it is possible to say that Connecticut's score of 4.97 on the Corporate Tax Index is better than its score of 2.81 on the Property Tax Index.

Time Frame Measured by the SBTCI

The first two editions of the SBTCI covered each state's tax climate as it existed in the calendar year starting January 1. For example, the 2004 SBTCI ranked each state as it entered calendar year 2004. Starting with the 2006 edition, the SBTCI has measured each state's business tax climate as it stands at the beginning of the standard state fiscal year, July 1. Therefore, this edition is the 2007 SBTCI and represents the tax climate of each state as of July 1, 2006, the first day of fiscal year 2007 for most states.

The District of Columbia

The District of Columbia (DC) is only included as an exhibit and does not affect the relative scores among states.

CORPORATE TAX INDEX

The first of the five major component indexes that comprise the State Business Tax Climate Index measures the impact of each state's principal tax on business activities. It is well established that the extent of business taxation can affect a business's level of economic activity within a state. For example, Newman (1982) found that differentials in state corporate income taxes were a major factor influencing the movement of industry to southern states. Two decades later, with global investment greatly expanded, Agostini and Tulayasathien (2001) determined that a state's corporate tax rate is the most relevant tax in the investment decisions of foreign investors.

The Corporate Tax Index consists of two distinct, equally weighted sub-indexes—one that measures the impact of the rate structure and one that measures the composition of the business tax base. These two sub-indexes are explained, with notes about which states scored particularly well or poorly on each, and every variable included in the index is described in detail. The final score of the Corporate Tax Index is compiled from these variables and the entire Corporate Tax Index accounts for 19.43 percent of each state's total score. See Tables 8, 9, 10 and 11 in the appendix for details about how every state scores for each variable.

Most states levy standard corporate income taxes. Corporate income is generally defined as profit (gross receipts minus expenses). A growing number of states, however, impose taxes on the gross receipts of corporations with few or no deductions for expenses. In 2005, for example, Ohio enacted the Commercial Activities Tax (CAT) which taxes gross receipts in excess of $1,000,000 at the rate of 0.26 percent (when fully phased in). Washington has the Business and Occupation Tax (B&O) which is a multi-rate tax (depending on industry) on the gross receipts of Washington businesses. Kentucky, New Jersey,[12] and Texas have also recently enacted gross receipts taxes. Michigan also imposes a modified value added tax (VAT) that is more comparable to the base of a gross receipts tax than a corporate income tax.

It would clearly be unsound to compare Ohio's 0.26 percent tax on gross receipts to Indiana's 8.5 percent tax on corporate income, since the tax rates are applied to different bases. Prior editions of the SBTCI attempted to solve this problem by creating effective corporate income tax rates that could then be compared to the rates in other states.[13] With a larger number of states enacting

Hawaii

Hawaii's overall rank, 24th best, would be much higher if the state could reform its individual income tax without causing damage elsewhere in what is otherwise a good tax system. The top rate of 8.25% kicks in at $40,000 of taxable income. Only Maine and Oregon have a higher rate at such a low level of income. The blizzard of rates and brackets below that income level, nine in all, causes complexity and an economic drag.

[10] Derived by combining its zero rate on wages with its 5% rate on interest and dividend income.

[11] An average local option rate of 0.09 percent is added to its 3.90 percent state rate.

[12] New Jersey's gross receipts tax, called the Alternative Minimum Assesment (AMA), was phased out on July 1, 2006, for all companies except those companies who can claim protection under federal public law 86-272. Since these companies are mostly out of state, it is doubtful that New Jersey will be able to collect much revenue from them.

[13] The effective CIT rate of the SBT and B&O tax was calculated using collections data, for the B&O from the Washington state budget and for the SBT from the Census Bureau. The collections figures were divided by corporate income for both states, derived from IRS data. According to these calculations, Michigan's effective rate was the highest business tax rate at 15.08 percent and Washington's was second highest at 13.12 percent.

Table 3
Corporate Tax Index and Ranking, 2003, 2004, 2006 and 2007

	FY 2007 Corporate Tax Index		FY 2006 Corporate Tax Index		Change from 2006 to 2007		CY 2004 Corporate Tax Index		CY 2003 Corporate Tax Index	
State	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
Alabama	5.19	21	5.20	22	– 0.01	1	5.06	27	5.37	20
Alaska	4.98	27	4.98	28	– 0.01	1	4.99	29	4.96	29
Arizona	5.06	24	5.07	25	– 0.01	1	5.14	25	4.95	30
Arkansas	4.54	36	4.55	37	– 0.01	1	4.62	37	4.60	38
California	4.43	40	4.44	41	– 0.01	1	4.05	46	4.03	46
Colorado	5.61	15	5.62	15	– 0.01	0	5.62	15	5.60	15
Connecticut	4.97	28	5.31	18	– 0.34	– 10	5.15	24	5.12	25
Delaware	4.02	48	4.03	48	– 0.01	0	4.03	47	4.01	47
Florida	5.68	14	5.69	14	– 0.01	0	5.69	13	5.67	13
Georgia	5.96	6	5.97	6	– 0.01	0	5.97	6	5.95	6
Hawaii	5.84	9	5.85	9	– 0.01	0	5.85	9	5.82	9
Idaho	5.24	19	5.25	20	– 0.01	1	5.25	20	5.23	22
Illinois	4.93	30	4.93	30	– 0.01	0	5.58	16	5.56	16
Indiana	5.14	22	5.15	23	– 0.01	1	5.15	23	5.26	21
Iowa	4.24	46	4.25	44	– 0.01	– 2	4.25	41	4.23	42
Kansas	4.51	38	4.52	40	– 0.01	2	4.58	39	4.56	40
Kentucky	4.37	43	4.87	33	– 0.50	– 10	5.16	22	5.14	24
Louisiana	5.30	18	5.31	19	– 0.01	1	5.42	19	5.40	19
Maine	4.35	44	4.36	43	– 0.01	– 1	4.36	40	4.34	41
Maryland	5.91	7	5.92	7	– 0.01	0	5.92	7	5.89	7
Massachusetts	4.13	47	4.14	46	– 0.01	– 1	4.21	44	4.19	45
Michigan	3.45	50	3.46	49	– 0.01	– 1	3.51	49	3.49	49
Minnesota	4.29	45	4.21	45	0.08	0	4.24	42	4.22	43
Mississippi	5.85	8	5.86	8	– 0.01	0	5.86	8	5.84	8
Missouri	5.81	10	5.82	10	– 0.01	0	5.82	10	5.79	10
Montana	5.57	16	5.58	16	– 0.01	0	5.64	14	5.62	14
Nebraska	4.64	34	4.65	35	– 0.01	1	4.73	34	4.71	34
Nevada	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
New Hampshire	3.86	49	4.54	39	– 0.68	– 10	4.00	48	3.98	48
New Jersey	4.43	41	3.00	50	1.43	9	3.19	50	3.18	50
New Mexico	4.53	37	4.54	38	– 0.01	1	4.62	38	4.60	39
New York	5.07	23	5.08	24	– 0.01	1	5.08	26	5.06	26
North Carolina	4.99	25	5.00	26	– 0.01	1	5.03	28	5.00	27
North Dakota	4.96	29	4.97	29	– 0.01	0	4.17	45	4.64	36
Ohio	4.46	39	4.12	47	0.34	8	4.63	36	4.60	37
Oklahoma	5.70	13	5.70	13	– 0.01	0	5.71	12	5.68	12
Oregon	5.20	20	5.21	21	– 0.01	1	5.23	21	5.21	23
Pennsylvania	4.38	42	4.39	42	– 0.01	0	4.23	43	4.21	44
Rhode Island	4.58	35	4.58	36	– 0.01	1	4.66	35	4.64	35
South Carolina	5.79	11	5.80	11	– 0.01	0	5.80	11	5.78	11
South Dakota	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
Tennessee	5.72	12	5.73	12	– 0.01	0	5.42	18	5.51	17
Texas	5.33	17	5.34	17	– 0.01	0	5.43	17	5.41	18
Utah	6.21	4	6.22	4	– 0.01	0	6.25	4	6.22	4
Vermont	4.93	31	4.93	31	– 0.01	0	4.94	30	4.91	31
Virginia	6.16	5	6.17	5	– 0.01	0	6.17	5	6.14	5
Washington	4.82	33	4.83	34	– 0.01	1	4.83	32	4.81	33
West Virginia	4.99	26	5.00	27	– 0.01	1	4.83	33	4.98	28
Wisconsin	4.88	32	4.89	32	– 0.01	0	4.91	31	4.89	32
Wyoming	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
District of Columbia	2.18	-	2.19	-	-0.01	-	2.19	4.32	2.18	-

Note: States without any business tax rank equally as number 1.
Scores from 2003 and 2004 are calendar year; 2006 and 2007 are fiscal year.
Source: Tax Foundation

gross receipts taxes, however, we now separately compare gross receipts taxes to each other, and corporate income taxes to each other.

For states with corporate income taxes, the state's corporate tax rate sub-index is computed by assessing three key areas: the top tax rate, the level of taxable income at which the top rate kicks in, and the number of brackets. States that levy neither a corporate income tax nor a gross receipts tax clearly achieve a perfectly neutral system in regard to business income and so receive a perfect score.[14]

For states with gross receipts taxes—or their functional equivalent—the state's corporate tax rate sub-index is computed by assessing two key areas: the gross receipts tax rate, and whether the gross receipts rate is an alternative assessment or a generally applica-

ble tax. The latter variable was included so the states that levy a gross receipts tax as an alternative to the corporate income tax are not unduly penalized.

States that do impose a corporate tax generally will score well if they have a low rate. States with a high rate or a complex, multiple-rate system score poorly.

To compute the parallel sub-index for the corporate tax base, three broad areas are assessed: tax credits, treatment of net operating losses, and an "other" category that includes variables such as conformity to the Internal Revenue Code, protections against double taxation, and the taxation of "throwback" income provisions, among others. States that score well on the corporate tax base sub-index generally will have few business tax credits, generous carry-back and carry-forward provisions, deductions for net operating losses, conformity to the Internal Revenue Code, and provisions for alleviating double taxation.

The three states with no general corporate tax are Nevada, South Dakota and Wyoming, and they receive the highest scores on the Corporate Tax Index.

Among those states that do levy general corporate taxes, the five states with the best systems are Utah, Virginia, Georgia, Maryland and Mississippi. Each has a relatively low, single-rate system that applies to a broad base of business activity. Hawaii, Missouri, Tennessee and South Carolina also score well.

By contrast, Michigan has the lowest score because it has the highest gross receipts tax rate, 1.9 percent.[15] The other states rounding out the bottom ten are New Hampshire, Delaware, Massachusetts, Iowa, Minnesota, Maine, Kentucky, Pennsylvania and New Jersey. In general, these states have complex, multi-rate systems with high top marginal tax rates. Other factors that contribute to poor rankings are numerous tax credits, restrictive treatment of net operating loss and the double taxation of income. Delaware and Ohio (ranked 48th and 39th respectively in the Corporate Tax Index) are the only states to levy both full corporate income taxes and gross receipts taxes on businesses in their state. Although Ohio is currently phasing out its franchise tax (essentially equivalent to a corporate income tax) through 2010, until then it will have two corporate tax structures: the franchise tax and the new gross receipts tax, called the Corporate Activities Tax (CAT). If Ohio maintains the low 0.26 percent CAT rate, the full phase-out of the franchise tax will improve its score on the corporate component index. Kentucky's gross receipts tax is an alternative tax, explained below. See Table 3 for a ranking of all the states.

Sub-Index #1: The Corporate Tax Rate

The corporate tax rate sub-index is designed to gauge how a state's corporate income tax top rate, bracket structure, and gross receipts rate affect its competitiveness compared to other states, as the extent of taxation can affect a business's level of economic activity within a state (Newman, 1982).

A state's corporate tax is levied in addition to the federal corporate income tax rate, which varies from 15 percent on the first dollar of income to a top rate of 35 percent.[16] This top rate is higher than the corporate income tax rate in all but a few industrial nations. In many states, federal and state corporate tax rates combine to levy the highest corporate tax rates in the world.[17]

On the other hand, there are three states that levy neither a corporate income tax nor a gross receipts tax: Nevada, South Dakota and Wyoming. These states automatically score a perfect 10 for this sub-index. Therefore, this section ranks the remaining 47 states relative to each other. A discussion of each variable follows.

THE TOP RATE

Iowa's 12 percent corporate income tax rate qualifies for the worst ranking among states that levy one, followed by Pennsylvania's 9.99 percent rate. Other states with comparatively high corporate income tax rates are the District of Columbia (9.975 percent); Minnesota (9.8 percent); Vermont (9.75 percent);

[14] See Methodology for discussion of how the index scores states that have a given tax along with states that have not enacted one.

[15] In August 2006, the Michigan legislature voted to repeal the state's Single Business Tax (SBT) by the end of 2007. Since the vote was incident to a voter petition, Governor Granholm could not veto the measure. Currently the debate is centered on how to replace the SBT.

[16] For firms with less than $50,000 in taxable income, the rate is 15 percent. The rate is 25 percent on the next $25,000 in income; and for firms with taxable income between $75,000 and $10,000,000, the rate is 34 percent. Above that, the marginal rate is 35 percent, although "manufacturing" firms benefited from a preference equal to one percentage point in 2005. State taxes are deductible on the federal return so the statutory rates at the federal and state levels cannot be simply added.

[17] See Chris Atkins and Scott Hodge, "U.S. Lagging Behind OECD Corporate Tax Trends," *Tax Foundation Fiscal Fact,* No. 55 (May 5, 2006), located at http://www.tax-foundation.org/publications/show/1466.html.

Massachusetts (9.5 percent); Alaska (9.4 percent); New Jersey (9.36 percent including a 4 percent surcharge for 2006); New Hampshire[18] (9.25 percent); and Connecticut,[19] Rhode Island, and West Virginia (9 percent). States that levy just a gross receipts tax are counted as having a top corporate income tax rate of zero percent. Currently this applies only to Washington and Michigan, but it will soon apply to Texas (2007) and Ohio (2010).

By contrast, Texas's top tax rate of 4.5 percent qualifies it for the best score in this category.[20] Other states with comparatively low top corporate tax rates are Colorado (4.63 percent), Mississippi (5 percent), South Carolina (5 percent), and Utah (5 percent).

Among states that levy gross receipts taxes, Michigan's rate is the highest (1.9 percent),[21] followed by Delaware (0.576 percent), Washington (0.484 percent), Ohio (0.104 percent), and Kentucky (0.095 percent).[22] Ohio's rate is phasing in and will reach 0.26 percent in 2009. Texas just passed a new gross receipts tax which will have a top rate of 1 percent that will take effect January 1, 2007.

THE GRADUATED RATE STRUCTURE

Two variables are used to measure the economic drag created by multiple-rate corporate income tax systems: the kick-in of the top bracket (the level of income at which the highest tax rate starts) and the number of tax brackets. Thirty-one states and the District of Columbia have flat, single-rate systems and they score best. Flat-rate systems are consistent with the sound tax principles of simplicity and neutrality. A flat system does not impact the economic decisions of businesses as they become more successful and earn additional income.

The Top Bracket

This variable measures how soon a state's tax system applies its highest corporate income tax rate. States score best if their top rate kicks in at a low level of income, since the lower the top rate kicks in, the more the system is like a flat tax. However, states also score well if their top rate kicks in at a very high level of income since fewer companies pay tax at that rate. New Mexico ($1,000,000), Iowa ($250,000), Vermont ($250,000) and Maine ($250,000) score the best since their top rates kick in at high levels of income.[23] States with flat systems also score best since their top rate kicks in at zero. States where the top rate kicks in at medium levels of income score the worst. Arkansas, Kentucky, Hawaii and New Jersey all score poorly because their top rates kick in at $100,000.

The Number of Brackets

An income tax system creates changes in behavior when the taxpayer's income reaches the end of one tax rate bracket and moves into a higher bracket. At such a break point, incentives change, and as a result, numerous rate changes are more economically harmful than a single rate structure. This variable is intended to measure the disincentive effect the corporate income tax has on rising incomes. States that score the best on this variable are the 31 states and the District of Columbia that have a single-rate system. Alaska's 10-bracket system earns the worst score in this category. Other states with multi-bracket systems include Arkansas (6 brackets), North Dakota (5 brackets), and Louisiana (5 brackets).

Sub-Index #2: The Corporate Tax Base

This sub-index measures the economic impact of each state's definition of what should be subject to corporate taxation.

Under a corporate income tax, three criteria used to measure the competitiveness of each state's tax

[18] New Hampshire has a dual corporate income tax with differing tax bases: the Business Profit Tax (BPT) and Business Enterprise Tax (BET).The BPT has a rate of 8.5 percent if gross income is over $50,000, and the BET has a rate of 0.75 percent if gross income is over $150,000 or if the base (total compensation, interest and dividends paid) is over $75,000. As a result, the top tax rate a corporation may face is the BPT rate plus the BET rate for a combined rate of 9.25 percent.

[19] Connecticut imposes an additional 20 percent surtax in 2006.

[20] Texas's 4.5 percent tax on taxable earned surplus is similar to a traditionally defined corporate income tax with the major difference being a larger tax base (federal net taxable income plus compensation paid to officers and directors of the corporation). The 0.25 percent tax on taxable capital that a corporation must pay if it yields more tax than the 4.5 percent tax on earned surplus is essentially a "wealth tax." For the rate analysis, Texas's Corporate Income Tax Index score is based on the 4.5 percent earned surplus tax. The tax on capital is included in the tax base sub-index. Texas recently eliminated its franchise tax in favor of enacting a new gross receipts tax (called the margins tax) which becomes effective on January 1, 2007, and will be included in the 2008 State Business Tax Climate Index.

[21] Since Michigan's SBT is not a pure gross receipts tax, it can be a bit misleading to compare its rate even to the rates in states with pure gross receipts taxes. This problem is addressed by taking account of a deduction for excess compensation in the base component of this sub-index.

[22] Kentucky's gross receipts tax is an alternative assessment. Companies doing business in Kentucky compute liability under the corporate income tax and the gross receipts tax, and pay whichever tax is higher.

[23] States with kick-in levels that are more than one standard deviation higher than the average kick-in level receive a perfect score.

base are given equal weight: the availability of certain credits, deductions and exemptions; the ability of taxpayers to deduct net operating losses; and a host of smaller tax base issues combine to make up the other third of the corporate tax base.

Under a gross receipts tax, these tax base criteria are replaced by the availability of deductions from gross receipts for employee compensation costs and cost of goods sold. States are rewarded for granting these deductions because they diminish the greatest disadvantage of using gross receipts as the base for corporate taxation: the uneven effective tax rates that various industries pay, depending on how many levels of production are hit by the tax.

The three states that levy neither a corporate income tax nor a gross receipts tax —Nevada, South Dakota and Wyoming—receive a perfect score for this sub-index. Of the 47 states with one or both taxes, Virginia, Maryland, Utah and Hawaii receive the best scores. By contrast, New Hampshire has the worst score, followed by Arkansas, Kentucky, Michigan and Kansas.

NET OPERATING LOSSES

The corporate income tax is designed to tax only the profits of a corporation. However, a yearly profit snapshot may not fully capture a corporation's true profitability. For example, a corporation in a highly cyclical industry may look very profitable during boom years but lose substantial amounts during bust years. When examined over the entire business cycle, the corporation may actually have an average profit margin.

The deduction for net operating losses (NOL) helps insure that, over time, the corporate income tax is a tax on average profitability. Without the NOL deduction, corporations in cyclical industries pay much higher taxes than those in stable industries, even assuming identical average profits over time. Put simply, the NOL deduction helps level the playing field among cyclical and non-cyclical industries. The federal government currently allows a two-year carry-back cap and a 20-year carry-forward cap, and these two variables are taken into account as the index assesses state tax systems.

Number of Years Allowed for Carry-Back and Carry-Forward

This variable measures the number of years allowed on a carry-back or carry-forward of an NOL deduction. The longer the overall time span, the higher the probability that the corporate income tax is being levied on the corporation's average profitability. Generally, states entered 2007 with better treatment of the carry-forward (up to a maximum of 20 years) than the carry-back (up to a maximum of three years).

Caps on the Amount of Carry-Back and Carry-Forward

When companies have a bigger NOL than they can deduct in one year, most states permit them to carry deductions of any amount back to previous years' returns or forward to future returns. States that limit those amounts are downgraded in the Index. Five states limit the amount of carry-backs: Delaware, Idaho, New York, Utah and West Virginia. Only Pennsylvania and New Hampshire limit carry-forwards. As a result, these states score poorly in this variable.

TAX CREDITS

Many states provide tax credits to lower the effective tax rates for certain industries and/or investments, often for large firms from out of state who are considering a move. Lawmakers create these deals under the banner of job creation and economic development, but the truth is that if a state needs to offer such packages, it is most likely covering for a woeful business tax climate. Tax credits complicate the tax system, narrow the tax base, drive up tax rates for existing companies and distort the free market.

A far more effective approach is to systematically improve the business tax climate for the long term so as to improve the state's competitiveness as compared to other states. Thus, this component index rewards those states that do not offer the following tax credits, and states that offer them score poorly.

Investment Tax Credits

Investment tax credits typically offer an offset against tax liability if the company invests in new property, plants, equipment, or machinery in the state offering the credit. Sometimes, the new investment will have to be "qualified" and approved by the state's economic development office. Investment tax credits distort the free market by encouraging investment in new property as opposed to the renovation of old property.

Job Tax Credits

Job tax credits typically offer an offset against tax liability if the company creates a specified number of jobs over a specified period of time. Sometimes, the new jobs will have to be "qualified" and approved by the state's economic development office, allegedly to prevent firms from claiming that jobs shifted were jobs added. Even if administered efficiently, which is uncommon, job tax credits can misfire in a number of ways. They push businesses

whose economic position would be best served by spending more on new equipment or marketing to hire new employees instead. They reward businesses who are expanding anyway, punishing firms that are already struggling. Thus, states that offer such credits score poorly on the Index.

Research and Development (R&D) Tax Credits

R&D tax credits reduce the amount of tax due by a company that invests in "qualified" research and development activities. The theoretical argument for R&D tax credits is that they encourage the kind of basic research that is not economically justifiable in the short run but that is better for society in the long run. In practice, we find that its negative side effects —greatly complicating the tax system and establishing a government agency as the arbiter of what types of research meet a criterion so difficult to assess – far outweigh the potential benefits. Thus, states that offer such credits score poorly on the Index.

GROSS RECEIPTS TAX DEDUCTIONS

Proponents of gross receipts taxation invariably praise the steadier flow of tax receipts into government coffers, in comparison with the fluctuating revenue generated by corporate income taxes, but this stability comes at a great cost. Firms with few steps in production are relatively lightly taxed under a gross receipts tax, and low-volume, high-margin firms prosper. At the same time, industries that require numerous stages of production pay tax at each stage, and high-volume, low-margin firms suffer. The pressure of this economic imbalance usually leads lawmakers to enact separate rates for each industry, an inevitably unfair and inefficient process.

Two reforms that states can make to mitigate this damage are to permit deductions from gross receipts for employee compensation costs and cost of goods sold, effectively moving toward a regular corporate income tax.

Washington and Michigan score the worst because they do not offer full deductions for either cost of goods sold or employee compensation, although Michigan does get partial credit for its limited deduction for employee compensation costs. The other gross receipts states score poorly as well. However, Delaware, Kentucky and Ohio do receive partial credit. Ohio and Delaware tax both gross receipts and corporate profits, and under their regular corporate income tax, they do allow the deductions. Kentucky's gross receipts tax is an alternative tax: firms must pay either the corporate income tax or the gross receipts tax but not both.

If a state levies a gross receipts tax, it is rewarded for allowing full deductions for employee compensation and cost of goods sold.

Iowa

Iowa owes its poor ranking, 43rd best, to its income tax system. The rates on both personal and corporate income stand out as a warning to entrepreneurs. Individuals face an escalating series of nine tax rates that hit 8.98% over $57,106. Only a few states have enacted such a high rate at all, and those that have one usually apply it to a higher level of income. On corporate income, Iowa's 12% rate is in a league of its own. No other state has a double-digit rate on the books.

OTHER SIGNIFICANT FEATURES

Federal Income Used as State Tax Base

States that use federal definitions of income help reduce the tax compliance burden on their taxpayers.[24] Two states do not conform to federal definitions of corporate income—Arkansas and Mississippi—and they score poorly.

Allowance of Federal ACRS and MACRS Depreciation

The vast array of federal depreciation schedules is, by itself, a tax complexity nightmare for businesses. The specter of having 50 different schedules would be a disaster from a tax complexity standpoint. This variable measures the degree to which states have adopted the federal ACRS and MACRS depreciation schedules.[25] Two states that add complexity by failing to fully conform to the federal system are California and Michigan.

Deductibility of Depletion

The deduction for depletion works similarly to depreciation, but it applies to natural resources. As with depreciation, tax complexity would be staggering if all 50 states imposed their own depletion schedules. This variable measures the degree to which states have adopted the federal depletion schedules.[26] Eleven states are penalized because they do not fully conform to the federal system: Alabama, Minnesota, Oregon and Wisconsin do not comply while Alaska, Delaware, Iowa, Louisiana, New Hampshire, North Carolina and Texas only partially comply.

The Alternative Minimum Tax

The Alternative Minimum Tax (AMT) was created to ensure that all taxpayers paid some minimum level of taxes every year. Unfortunately, it creates a parallel tax system to the standard corporate income tax code. Evidence shows that the AMT does not increase efficiency or improve fairness in any meaningful way. It nets little money for the government, imposes compliance costs that in some years are actually larger than collections, and encourages firms to cut back or shift their investments (Chorvat and Knoll, 2002). As such, states that have mim-

icked the federal AMT put themselves at a competitive disadvantage through needless tax complexity. Eight states have an AMT on corporations—Alaska, California, Florida, Iowa, Kentucky, Maine, Minnesota, and New York—and score poorly.[27]

Deductibility of Taxes Paid

This variable measures the extent of double taxation on income used to pay foreign taxes, i.e., paying a tax on money the taxpayer has already mailed to foreign taxing authorities. States can avoid this double taxation by allowing the deduction of taxes paid to foreign jurisdictions. Twenty-four states allow deductions for foreign taxes paid and score well. The remaining twenty-six states do not allow deductions for foreign taxes paid and thus score poorly.

Indexation of the Tax Code

Indexing the tax code for inflation is critical in order to prevent de facto tax increases on the nominal increase in income due to inflation. Put simply, this "inflation tax" results in higher tax burdens on taxpayers, usually without their knowledge or consent. Seventeen states do not index their corporate income tax brackets[28]: Alaska, Arkansas, Hawaii, Iowa, Kansas, Kentucky, Louisiana, Maine, Michigan,[29] Mississippi, Nebraska, New Hampshire, New Jersey, New Mexico, North Dakota, Ohio and Vermont.[30]

Throwback

To reduce the double taxation of corporate income, states use an apportionment system that seeks to determine how much of a company's income a state has the right to tax. Generally, states require a company with nexus (that is, sufficient connection to the state to justify the state's right to tax its income) to apportion its income to the state based on in-state property, payroll and sales compared to total property, payroll and sales.

Among the 50 states, there is little harmony in apportionment formulas. Many states equally weight the three factors while others weight the sales factor more heavily (a recent trend in state tax policy). Since many businesses make sales into states where they do not have nexus, businesses can end up with "nowhere income," income that is not taxed by any state. To counter this phenomenon, many states have adopted what are called throwback rules because they identify nowhere income and throw it back into a state where it will be taxed. There are two reasons why this is penalized by the SBTCI.

First, throwback rules embrace the questionable assumption that all income must be taxed somewhere, and in doing so they violate the general corporate tax rule that sales are sourced to their destination and not to their origin. Second, throwback rules add yet another layer of tax complexity. Since two or more states can theoretically lay claim to "nowhere" income, rules have to be created and enforced to decide who gets to tax it.

States are almost evenly divided between those with and without throwback rules. Twenty-six states do not have them and twenty-four states and the District of Columbia do.

INDIVIDUAL INCOME TAX INDEX

The individual income tax code in each state is also a consideration for business. One important reason is that a significant number of businesses, including sole proprietorships, partnerships and S-corporations, report their income through the individual income tax code. Indeed, the number of individuals filing federal tax returns with business income has nearly doubled over the past 20 years, from 13.3 million in 1980 to 25.5 million in 2002.[31]

Taxes can have a significant impact on an individual's decision to become a self-employed entrepreneur. Gentry and Hubbard (2004) found, "While the level of the marginal tax rate has a negative effect on entrepreneurial entry, the progressivity of the tax also discourages entrepreneurship, and

[24] This is not an endorsement of the economic efficiency of the federal definition of corporate income.

[25] This is not an endorsement of the federal ACRS/MACRS depreciation system. It is well known that federal tax depreciation schedules often bear little resemblance to actual economic depreciation rates.

[26] This is not an endorsement of the economic efficiency of the federal depletion system.

[27] Five of these states impose both corporate and individual AMT's: California, Iowa, Maine, Minnesota and New York. An individual AMT sub-index is contained within the Individual Income Tax Major Index.

[28] This variable only looks at states that have statutory automatic provisions to index for inflation. This does not reflect recent or ongoing legislative activity.

[29] Michigan allows a $45,000 deduction, in essence creating a two-rate system with rates of 0 and 1.9 percent. The deduction is not indexed for inflation.

[30] States with a single-rate system do not have any brackets to adjust for inflation and are therefore treated as if they were indexation states.

[31] Scott A. Hodge and J. Scott Moody, "Wealthy American and Business Activity," *Tax Foundation Special Report,* No. 131, August 1, 2004.

significantly so for some groups of households." (p. 21) Using education as a measure of potential for innovation, Gentry and Hubbard found that a progressive tax system "discourages entry into self-employment for people of all educational backgrounds." Moreover, citing Carroll, Holtz-Eakin, Rider and Rosen (2000), Gentry and Hubbard contend, "Higher tax rates reduce investment, hiring, and small business income growth." (p. 7) Less neutral individual income tax systems, therefore, hurt entrepreneurship and a state's business tax climate.

Another important reason individual income tax rates are critical for business is the cost of labor. Labor typically constitutes a major business expense, so anything that hurts the labor pool will also affect business decisions and the economy. Complex, poorly designed tax systems that extract an inordinate amount of tax revenue are known to reduce both the quantity and quality of the labor pool. This finding was supported by Wasylenko and McGuire (1985), who found that individual income taxes affect businesses indirectly by influencing the location decisions of individuals. A progressive, multi-rate income tax exacerbates this problem by systematically ratcheting up the marginal tax rate at higher levels of income. Thus the tax system continually reduces the value of work vis-à-vis the value of leisure.

For example, suppose a worker has to choose between one hour of additional work worth $10 and one hour of leisure which to him is worth $9.50. A rational person would choose to work for another hour. But if a 10-percent income tax rate reduces the after-tax value of labor to $9.00, then a rational person would stop working and take the hour to pursue leisure. Additionally, workers earning higher wages—$30 an hour, for example—that face progressively higher marginal tax rates—20 percent, for instance—are more likely to be discouraged from working additional hours. In this scenario, the worker's after-tax wage is $24 an hour, therefore those workers that value leisure more than $24 an hour will chose not to work. Since the after-tax wage is $6 lower than the pre-tax wage in this example, compared to only $1 lower in the previous example, more workers will chose leisure. In the aggregate, the income tax reduces the available labor supply.[32]

Aside from measuring the economic impact of each state's individual income tax on wage earners, the Individual Income Tax Index measures the impact on non-corporate businesses. Because sole proprietorships, partnerships and S-corporations report business income not on corporate tax returns but on individual tax returns, the structure of the individual income tax code is critical to the business tax climate for these firms.

The individual rate sub-index measures the impact of tax rates on the marginal dollar of individual income using three criteria; the top tax rate, the graduated rate structure, and standard deductions and exemptions, which are treated as a zero percent tax rate. The rates and brackets used are for a single taxpayer, not a couple filing a joint return.[33]

Like the Corporate Tax Index, the Individual Income Tax Index is comprised of two complex sub-indexes measuring the states' tax rate structures and tax bases. Tax rate structure is assessed in four key areas: the states' top marginal tax rates (including local option income rates if a state allows them), the starting points of their top brackets, the number of brackets and the average width of brackets. States that do not impose an individual income tax receive a perfect score, and states that do will generally score well if they have a flat, low tax rate with few deductions and exemptions. States that score poorly have complex, multiple-rate systems.

States' tax bases are assessed on a variety of factors, including: how the tax code treats married couples, the lengths to which a tax code goes to prevent double taxation, and whether the code is indexed for inflation. States that score well protect married couples from being taxed more severely than if they had filed as two single people. They also protect taxpayers from double taxation by recognizing LLCs and S-corps under the individual tax code and indexing their brackets, exemptions and deductions for inflation.

The seven states without an individual income tax are, naturally, the highest scoring states on this component index: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming.

New Hampshire and Tennessee also score well because, while they levy a significant tax on individual income in the form of interest and dividends, they do not tax wages and salaries. Of the 41 states that do have a broad-based individual income tax, Pennsylvania, Indiana, Michigan, Illinois and Colorado score highly because they have a single, low tax rate.

On the other hand, New Jersey has the worst score because it began the fiscal year with a high top rate, 8.97 percent (plus a state average .09 percent local add-on income tax rate which gives it a top rate of 9.06), which sits atop six lower statutory rates plus a zero rate created by its deductions and exemptions (giving it a total of seven brackets). The other states rounding out the bottom ten are Ohio, Rhode Island, Vermont, California, Iowa, North Dakota, North Carolina, Wisconsin and West Virginia. The individual income tax systems in these states are plagued by high tax rates and progressive

bracket structures. They generally fail to index their brackets, exemptions and deductions for inflation, do not allow for deductions of foreign or other state taxes, penalize married couples filing jointly, and do not recognize LLCs and S-Corps. See Table 4 for a 50-state ranking.

Similar to the Corporate Tax Index, the Individual Income Tax Index consists of two equally weighted sub-indexes—one to measure the impact of the rate structure and one to measure the competitiveness of each state's tax base. These two sub-indexes are defined below, with every variable discussed, and states that score especially well or poorly are noted. The final score of the Individual Income Tax Index accounts for 29.15 percent of each state's total score on the State Business Tax Climate Index. See Tables 12, 13 and 14 in the appendix.

Sub-Index #1: The Individual Income Tax Rate

The sub-index compares the 43 states that tax individual income after setting aside the seven states that levy no individual income tax and therefore receive perfect scores: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Among the other 43, two equally weighted variables are considered to calculate the rate sub-index score: the top tax rate and the graduated rate structure. New Hampshire, Tennessee, Illinois, Pennsylvania, Michigan, Indiana and Colorado scored the best. California, Ohio, Rhode Island, Iowa and New Jersey had the five worst scores. A discussion of each variable follows.

THE TOP MARGINAL TAX RATE

California imposes the highest top statutory rate of 10.3 percent, which it imposes on incomes over $1 million. Other states with high top tax rates include Rhode Island (9.9 percent),[34] Vermont (9.5 percent), the District of Columbia (9.0 percent), Oregon (9.0 percent), Iowa (8.98 percent), and New Jersey (8.97 percent).

Among those states with the lowest rates, New Hampshire (0.8 percent) and Tennessee (0.96 percent) score the best.[35] Other states with relatively low top rates include: Illinois (3.0 percent of federal AGI); Pennsylvania (3.07 percent); Michigan (3.9 percent of federal AGI with modification); Indiana (3.4 percent of federal AGI); Colorado (4.63 percent of federal taxable income); Arizona (4.79 percent); Alabama, Connecticut and Mississippi (5 percent).

If only state-level tax rates were considered, Maryland would be in this group of states with the lowest top rates. However, municipal[36] and county-level income taxes are also counted and as a result, Maryland's average local rate of 2.73 percent is added to its 4.75 percent state-level rate—for a combined rate of 7.48 percent.[37]

Other states with local option income taxes added on to the top state rate include: Alabama (0.19 percent added for a total of 5.19 percent), Arkansas (0.058 percent added for a total of 7.058 percent), Delaware (0.88 percent added for a total of 6.83 percent), Indiana (0.97 percent added on for a total of 4.37 percent), Kentucky (0.93 added for a total of 6.93 percent), Michigan (0.09 added for a total of 3.99 percent), Missouri (0.38 percent for a total of 6.38 percent), New Jersey (0.09 percent added on for a total of 9.06 percent), New York (0.62 percent added on for a total of 7.47), Ohio (1.74 percent added on for a total of 8.32 percent),[38] Oregon (0.64 percent added on for a

[32] For a more detailed explanation, see Fleenor and Moody (1999).

[33] In many states, tax brackets, deductions and exemptions for joint filers are simply twice that of a single filer's. Therefore, the relative economic impacts are similar. For states where they are not doubled, there exists a "marriage penalty" which is measured in the marriage penalty category of the tax base sub-index.

[34] Rhode Island's top tax rate is computed as 25 percent of the top federal tax rate in 2000 (39.6 percent), or 9.9 percent. Rhode Island recently enacted an alternative flat tax with an 8-percent rate for individuals making over $250,000.

[35] New Hampshire and Tennessee both tax only interest and dividends. To make their top tax rates comparable to other states, the Index calculates the rate needed to collect the same revenue as a typical income tax. Nationally, dividends and interest account for 15.97 percent of income. For New Hampshire, its 5 percent rate was multiplied by 15.97 percent, yielding the equivalent rate of 0.8 percent. For Tennessee, with a tax rate of 6 percent, this calculation yields an equivalent rate of .96 percent.

[36] The 2007 edition of the SBTCI is the first to include municipal level individual income tax rates.

[37] The local income tax rate add-ons are calculated by using a weighted average of each locality's rate. The locality's portion of the state's personal income is used as the weight. For example, in New Jersey large municipalities with populations over 200,000, can impose a payroll tax. Newark is the only city to do so currently by imposing a 1 percent tax rate. Newark's share of the state's total personal income is then used as a weight and multiplied by the 1 percent rate thereby calculating New Jersey's .09 percent add-on rate.

[38] Ohio is currently phasing down its top individual income tax rate through 2010, at which time the top rate will be 5.925 percent. In 2006, Ohio's top state rate will be 6.58 percent. In July 2006, Ohio lawmakers decided to accelerate the phase down of the top rate. It will be cut an additional 8.4 percent in October 2006. However, this cut does not occur until after the snapshot date of July 1, 2006, so Ohio does not receive credit for the acceleration.

Table 4
Individual Income Tax Index and Ranking, 2003, 2004, 2006 and 2007

	FY 2007 Individual Income Tax Index		FY 2006 Individual Income Tax Index		Change from 2006 to 2007		CY 2004 Individual Income Tax Index		CY 2003 Individual Income Tax Index	
State	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
Alabama	5.38	20	5.38	19	0.00	– 1	5.39	19	5.37	20
Alaska	9.76	6	9.76	6	0.00	0	9.76	6	9.76	6
Arizona	5.01	29	4.96	28	0.04	– 1	4.70	34	5.28	22
Arkansas	4.89	30	4.91	30	– 0.02	0	4.92	27	4.89	29
California	3.43	46	3.43	45	0.00	– 1	4.22	41	4.17	42
Colorado	6.47	14	6.47	14	0.00	0	6.40	14	6.37	14
Connecticut	5.40	19	5.40	18	0.00	– 1	5.37	21	5.45	18
Delaware	4.79	33	4.81	33	– 0.02	0	4.76	33	4.68	35
Florida	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
Georgia	5.19	22	5.19	23	0.00	1	5.21	22	5.18	23
Hawaii	4.39	40	4.39	41	0.00	1	4.41	38	4.36	38
Idaho	4.83	31	4.84	31	0.00	0	4.86	29	4.82	30
Illinois	6.55	13	6.55	13	0.00	0	6.51	13	6.49	13
Indiana	6.82	11	6.83	10	– 0.01	– 1	7.02	10	7.00	10
Iowa	3.84	45	4.11	44	– 0.27	– 1	4.13	43	4.07	43
Kansas	5.19	23	5.19	22	0.00	– 1	5.15	23	5.09	25
Kentucky	4.39	39	4.57	38	– 0.18	– 1	5.38	20	5.35	21
Louisiana	5.09	27	5.09	26	0.00	– 1	4.80	32	4.72	33
Maine	4.66	36	4.66	36	– 0.01	0	4.69	35	4.66	36
Maryland	4.75	35	4.75	35	0.00	0	5.41	18	5.40	19
Massachusetts	6.32	15	6.32	15	0.00	0	6.30	15	6.26	15
Michigan	6.66	12	6.66	12	0.00	0	6.60	12	6.56	12
Minnesota	4.62	37	4.64	37	– 0.02	0	4.54	37	4.45	37
Mississippi	5.67	16	5.67	16	0.00	0	5.64	16	5.61	16
Missouri	5.11	24	5.12	24	– 0.01	0	5.14	24	5.11	24
Montana	5.37	21	5.38	20	– 0.01	– 1	3.58	46	3.51	46
Nebraska	4.81	32	4.82	32	– 0.01	0	4.80	31	4.79	32
Nevada	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
New Hampshire	7.19	9	7.82	9	– 0.64	0	7.73	9	7.72	9
New Jersey	2.49	50	2.61	49	– 0.12	– 1	4.40	39	4.31	39
New Mexico	5.46	18	5.27	21	0.20	3	4.59	36	4.21	41
New York	4.51	38	2.70	48	1.82	10	2.45	50	3.19	47
North Carolina	4.17	43	4.19	43	– 0.02	0	4.01	45	3.86	45
North Dakota	4.17	44	4.31	42	– 0.14	– 2	4.06	44	4.03	44
Ohio	2.52	49	2.57	50	– 0.05	1	3.11	48	3.09	49
Oklahoma	5.10	25	4.93	29	0.16	4	4.89	28	4.94	28
Oregon	4.77	34	4.77	34	0.00	0	4.84	30	4.82	31
Pennsylvania	6.83	10	6.83	11	0.00	1	6.87	11	6.85	11
Rhode Island	2.76	48	2.87	47	– 0.11	– 1	2.67	49	2.61	50
South Carolina	5.09	26	5.10	25	– 0.01	– 1	5.12	25	5.09	26
South Dakota	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
Tennessee	7.79	8	8.11	8	– 0.33	0	8.02	8	8.00	8
Texas	9.52	7	9.52	7	0.00	0	9.52	7	9.52	7
Utah	5.03	28	5.03	27	0.00	– 1	5.06	26	5.05	27
Vermont	3.22	47	3.39	46	– 0.17	– 1	3.21	47	3.16	48
Virginia	5.52	17	5.52	17	0.00	0	5.50	17	5.47	17
Washington	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
West Virginia	4.39	41	4.41	39	– 0.03	– 2	4.35	40	4.27	40
Wisconsin	4.35	42	4.41	40	– 0.06	– 2	4.20	42	4.70	34
Wyoming	10.00	1	10.00	1	0.00	0	10.00	1	10.00	1
District of Columbia	4.57	-	4.51	-	0.06	-	4.09	-	4.34	-

Note: States without an individual income tax rank equally as number 1.
Scores from 2003 and 2004 are calendar year; 2006 and 2007 are fiscal year.
Source: Tax Foundation

total of 9.64 percent) and Pennsylvania (0.52 percent for a total of 3.59 percent). Even though Alabama, Indiana, Michigan and Pennsylvania allow for local income add-ons, they are still among the states with the lowest overall rates.

GRADUATED RATE STRUCTURE

This sub-index measures the impact of a graduated individual income tax structure via three variables: the level of taxable income at which the top rate takes effect, the number of tax brackets and the average width of those brackets.

Top Tax Bracket Kick-In

The income level at which a state's top rate kicks in determines what amount of income is subject to the top rate. States are rewarded for either taxing most income at the top rate (having a low kick-in level)

or taxing very little income at the top rate (having a very high kick-in threshold). States whose top rate kicks in at low levels of income effectively have flat rate systems and states where the kick-in is high have top rates that apply to few taxpayers.[39]

States with flat-rate systems score the best on this variable because their top rate kicks in at the first dollar of income (after accounting for the standard deduction and personal exemption). They include New Hampshire, Tennessee, Pennsylvania, Illinois, Indiana, Michigan, Massachusetts and Colorado. States with high kick-in levels also score well and they include California ($1,004,704), New Jersey ($501,000), North Dakota ($334,650), Rhode Island ($334,650) and Vermont ($334,650). States that score poorly have a kick-in that is in the middle range of income and do not have a flat rate system. They include Arizona ($156,225), Wisconsin ($141,421), North Carolina ($124,200), Kentucky ($77,243) and Minnesota ($72,060).

The Number of Brackets

New Hampshire, Pennsylvania and Tennessee score the best in this variable by having only one tax bracket. States with only two brackets are Colorado, Illinois, Indiana, Massachusetts and Michigan. On the other end of the spectrum, Missouri scores the worst in this variable by having 11 tax brackets. Other states with many brackets include Hawaii, Iowa and Ohio (all with ten brackets) and Idaho (nine brackets).

The number of brackets listed in a state's tax statutes is not always the number used to calculate the SBTCI. From an economic perspective, standard deductions and exemptions are equivalent to an additional tax bracket with a zero tax rate. As a result, their effects on the income tax have been incorporated into existing sub-indexes.

For example, Kansas has a standard deduction of $3,000 and a personal exemption of $2,250 for a combined value of $5,250. Statutorily, Kansas has a top rate on all taxable income over $30,000 and two lower brackets that have an average width of $15,000. But because of its deduction and exemption, Kansas's top rate actually kicks in at $35,250 of income, and it has three tax brackets below that with an average width of $11,750.

The size of allowed standard deductions and exemptions varies considerably.[40]

Connecticut has the largest standard deduction and exemptions ($12,625).[41] Wisconsin has the second highest ($8,840) and Mississippi the third highest ($8,300) while a number of states tie for fourth by conforming to the federal system of $8,200 (in 2005): Rhode Island, Colorado, Idaho, Minnesota, New Mexico, North Dakota, Vermont and South Carolina. On the other hand, Pennsylvania has no standard deduction or personal exemptions while Indiana and New Jersey allow taxpayers only a $1,000 personal exemption.

The Average Width of Brackets

Many states have several narrow tax brackets close together at the low end of the income scale. Most taxpayers never notice them because they pass so quickly through those brackets and pay the top rate on most of their income. On the other hand, some states continue placing additional, progressively higher rates throughout the income spectrum, causing individuals and non-corporate businesses to alter their income-earning and tax planning behavior. This sub-index punishes the latter group of states by measuring the average width of the brackets, rewarding those states where the average width is small, with the result that the top rate is levied on most income, acting effectively as a flat rate on all income.

The state that scores the best is Missouri, with an average bracket width of only $1,595. Other states with similar bracket structures include Indiana ($1,000), Pennsylvania ($1,585), Missouri ($1,610), Oklahoma ($1,671), Maryland ($1,850) and Utah ($1,952). California scores the worst in this variable with an average bracket width of $143,529. Other low-scoring states include New Jersey ($83,500), New York ($72,500), North Dakota ($67,060), Rhode Island and Vermont (both $66,930). As with the counting of the brackets, the "zero bracket" created by a standard deduction or exemption is factored into the calculation of the average width.

Sub-Index #2: The Individual Income Tax Base

States have different definitions of taxable income,

[39] States receive a perfect score if their top rate kicks in at a level of income that is more than one standard deviation higher than the average kick-in of all the states.

[40] Some states offer tax credits in lieu of income exemptions. Rather than excluding a portion of a taxpayer's income from the income tax, tax credits reduce a taxpayer's tax liability. The result is the same: a lower income tax bill. In order to maintain consistency within the sub-index, a tax credit is converted to an equivalent income exemption.

[41] In Connecticut, taxpayers receive a declining exemption and a personal tax credit. The exemption starts at $12,625 and phases out after $55,000 of income for single taxpayers.

and some create greater impediments to economic activity. This sub-index gives equal weight, 33 percent, to two major issues in base definition: marriage penalty and double taxation of capital income. Then it gives a 33 percent weight to an accumulation of more minor base issues.

Louisiana

Louisiana ranks in the middle or better on four of the five components of the climate index, but its sales tax system drags its overall ranking down to 30th best. Its 4% state-level rate seems modest, but its local option sales taxes are the highest nationwide, averaging 4.32%. Only New York comes close at 4.24%, and there are 19 states with no local sales taxes at all.

The five states with no individual income tax of any kind achieve perfect neutrality. Alaska and Texas also score well as they are only penalized for their treatment of LLCs and S-corps. Of the other 45 states, Montana, Tennessee, Missouri, Indiana, Massachusetts, Oregon and Idaho have the best scores. They avoid the marriage penalty and other problems with the definition of taxable income. Meanwhile, states where the tax base is found to cause an unnecessary drag on economic activity are New Jersey, Rhode Island, Ohio, North Dakota and Vermont.

MARRIAGE PENALTY

A marriage penalty exists when a state's standard deduction and tax brackets for married taxpayers filing jointly are not double those for single filers. As a result, two singles (if combined) can have a lower tax bill than a married couple filing jointly with the same income. This is discriminatory and has serious business ramifications. The top-earning 20 percent of taxpayers is dominated (85 percent) by married couples. This same 20 percent also has the highest concentration of business owners (43 percent) of all income groups (Hodge 2003A, Hodge 2003B). Because of these concentrations, marriage penalties affect a large majority of taxable income. States with the largest marriage penalties include New Jersey, Ohio, Rhode Island, Vermont and North Dakota.

Many states get around the marriage penalty problem by allowing married couples to file as if they were singles. While helpful in offsetting the marriage penalty, it comes at the expense of added tax complexity. Despite the complexity, the sub-index rewards states that have this provision.

DOUBLE TAXATION OF CAPITAL INCOME

Since all states with an individual income tax system mimic the federal income tax code, they also possess its greatest flaw—the double-taxation of capital income. Double taxation is brought about by the interaction between the corporate income tax and the individual income tax. The ultimate source of most capital income—interest, dividends and capital gains—is corporate profits. The corporate income tax reduces the level of profits that can eventually be used to generate interest or dividend payments or capital gains.[42] This capital income must then be declared by the receiving individual and taxed. The result is the double taxation of this capital income—first at the corporate level and again on the individual level.

All states with an individual income tax score poorly by this criterion except Tennessee and New Hampshire, which tax individuals on interest and dividends but not capital gains.

OTHER SIGNIFICANT ISSUES

The index includes several individual income tax base issues that significantly affect the neutrality of state individual income tax systems.

Federal Income Used as State Tax Base

Despite the shortcomings of the federal government's definition of income, states that use it help reduce the tax compliance burden on taxpayers. Eight states do not conform to federal definitions of individual income—Alabama, Arkansas, Iowa, Mississippi, New Hampshire, New Jersey, Pennsylvania and Tennessee—and score poorly.

The Alternative Minimum Tax

The Alternative Minimum Tax (AMT) was created at the federal level in 1969 to ensure that all taxpayers paid some minimum level of taxes every year. Unfortunately, it creates a parallel tax system to the standard individual income tax code. Evidence shows that the AMT is an inefficient way to prevent tax deductions and credits from totally eliminating tax liability. As such, states that have mimicked the federal AMT put themselves at a competitive disadvantage through needless tax complexity.

Twelve states have an AMT on individuals—California, Colorado, Connecticut, Iowa, Maine, Maryland, Minnesota, Nebraska, New York, Rhode Island, West Virginia and Wisconsin—and score poorly.

Deductibility of Taxes Paid

This variable measures the extent of double taxation on income used to pay foreign and state taxes, i.e., paying a tax on a tax. States can avoid double taxation by allowing a deduction for foreign taxes paid and state taxes paid to other jurisdictions.

Recognition of Limited Liability Corporation and S-Corporation Status

One important development in the federal tax system is the creation of the limited liability corpora-

tion (LLC) and the S-corporation (S-corp). LLCs and S-corps provide businesses some of the benefits of incorporation, such as limited liability, without the overhead of becoming a regular C-corporation. They also are taxed as individuals, which avoids the double-taxation problems that plague the corporate income tax system. Every state with a full individual income tax recognizes LLCs or S-corporations to at least some degree.

Indexation of the Tax Code

Indexing the tax code for inflation is critical in order to prevent de facto tax increases on the nominal increase in income due to inflation. Put simply, this "inflation tax" results in higher tax burdens on taxpayers, usually without their knowledge or consent. Three areas of the individual income tax are commonly indexed for inflation—the standard deduction, personal exemptions and tax brackets. Nineteen states index all three,[43] sixteen states and the District of Columbia do not index at all[44] and fifteen states index at least one of the three.

SALES TAX INDEX

The type of sales tax familiar to all taxpayers is a tax levied on the purchase price of a good or service at the point of sale. This point-of-sale tax can hurt the business tax climate because as the sales tax rate climbs, customers either make fewer purchases or seek out low-tax alternatives. As a result, business is lost to lower-tax locations, causing lost profits, lost jobs and lost tax revenue.[45] The effect of differential sales tax rates between states or localities is apparent when a traveler crosses the state line from a high-tax state to a neighboring low-tax state. Typically, a vast expanse of shopping malls has sprung up along the border in the low-tax jurisdiction.

On the positive side, sales taxes levied on goods and services at the point of sale to the end user have at least two virtues. They are "transparent," i.e., the tax is never confused with the price of goods by customers, and since they are levied at the point of sale, they are less likely to cause economic distortions than taxes levied at some intermediate stage of production.

More detrimental to the business climate are sales taxes levied on business-to-business transactions. When a business must pay sales taxes on manufacturing equipment and raw materials, then that tax becomes part of the price of whatever the business makes with that equipment and those materials. Of course, it must then collect sales tax on its own products, with the result that a tax is being charged on a tax. So-called "tax pyramiding" invariably results in some industries being taxed more heavily than others, which causes economic distortions.

Consider the following quote from David Brunori, contributing editor of *State Tax Notes:*

> A graduate student wrote me recently and asked what I thought was the most egregious flaw embedded in the state tax system. I told her that I thought there were about 100 flaws that could vie for the top spot. Here is one: the sales tax on business purchases. Everyone who has ever studied the issue will tell you that the sales tax should not be imposed on business purchases. That is, when a business purchases a product or service, it should not pay tax on the purchase. There is near unanimity among public finance scholars on the issue. The sales tax is supposed to be imposed on the final consumer. Taxing business purchases causes the tax to be passed on to consumers without their knowledge. There is nothing efficient or fair about that. But business purchases are taxed widely in every state with a sales tax. Some studies have estimated that business taxes make up nearly 50 percent of total sales tax revenue. Why? Two reasons. First, because business sales taxes raise so much money that the states cannot repeal them. The states would have to either raise

[42] Equity-related capital gains are not created directly by a corporation. Rather, they are the result of stock appreciations due to corporate activity such as increasing retained earnings, increasing capital investments or issuing dividends. Stock appreciation becomes taxable realized capital gains when the stock is sold by the holder.

[43] States with a single rate system that do not have any brackets to adjust for inflation are treated as if they were indexation states. These states include Colorado, Illinois, Indiana, Massachusetts, Michigan, New Hampshire and Tennessee.

[44] This variable only looks at states that have statutory automatic provisions to index the standard deduction, personal exemption or tax brackets to inflation. This does not reflect recent or ongoing legislative activity whose end result may be to adjust these provisions for the effects of inflation.

[45] Of course, states try to limit sales tax competition by levying a use tax on goods purchased out of state and brought into the state. Enforcement of use tax obligations against consumers is nearly impossible, especially after the Supreme Court's decision in *Quill v. Heitkamp,* 504 U.S. 298 (1992), where the Court ruled that vendors without physical presence (offices, employees, etc.) in a state could not be forced to collect use tax. The Streamlined Sales Tax Project is a current effort of state revenue commissioners and multistate businesses to harmonize state sales and use tax bases such that Congress could be justified in overturning the *Quill* decision.

other taxes or cut services. Second, many politicians think it is only fair that "businesses" pay taxes because individuals pay them. That ridiculous belief is unfortunately shared by many state legislators; it's usually espoused by liberals who don't understand that businesses aren't the ones who pay taxes. People do. Every time a business pays sales tax on a purchase, people are burdened. They just don't know it.[46]

The negative impact of sales taxes is well documented in the economic literature and through anecdotal evidence. For example, Bartik (1989) found that high sales taxes, especially sales taxes levied on equipment, had a negative effect on small business start-ups. Moreover, companies have been known to avoid locating factories or facilities in certain states because the factory's machinery would be subject to the state's sales tax.[47]

To understand how business-to-business sales taxes can distort the market, suppose a sales tax were levied on the sale of flour to a bakery. The bakery is not the end-user because the flour will be baked into bread and sold to consumers. Economic theory is not clear as to which party will ultimately bear the burden of the tax. The tax could be "passed forward" onto the customer or "passed backward" onto the bakery.[48] Where the tax burden falls depends on how sensitive the demand for bread is to price changes. If customers tend not to change their bread-buying habits when the price rises, then the tax can be fully passed forward onto consumers. However, if the consumer reacts to higher prices by buying less, then the tax will have to be absorbed by the bakery as an added cost of doing business.

The hypothetical sales tax on all flour sales would distort the market because different businesses that use flour have customers with varying price sensitivity. Suppose the bakery is able to pass the entire tax on flour forward to the consumer, but the pizza shop down the street cannot. The owners of the pizza shop would face a higher cost structure and profits would drop. Since profits are the market signal for opportunity, the tax would tilt the market away from pizza-making. Fewer entrepreneurs would enter the pizza business, and existing businesses would hire fewer people. In both cases, the sales tax charged to purchasers of bread and pizza would be partly a tax on a tax because the tax on flour would be built into the price. Economists call this tax pyramiding.

Besley and Rosen (1998) found that for many products, the after-tax price of the good increased by the same amount as the tax itself. That means a sales tax increase was passed along to consumers on a one-for-one basis. For other goods, however, they found that the price of the good rose by twice the amount of the tax, meaning that the tax increase translates into an even larger burden for consumers than is typically thought.

The Sales Tax Index is weighted so that it makes up 21.5 percent of a state's total score on the SBTCI. See Tables 15, 16 and 17 in the appendix for details of each state's sales tax system. It is comprised of two equally weighted sub-indexes devoted

[46] David Brunori, "An Odd Admission of Gambling," *State Tax Notes,* Jan. 30, 2005, p. 332-339.

[47] In early 1993, Intel Corporation was considering California, New Mexico and four other states as the site of a new billion dollar factory. California was the only one of the six states that levied its sales tax on machinery and equipment, a tax that would have cost Intel roughly $80 million. As Intel's Bob Perlman put it in testimony before a committee of the California state legislature, "There are two ways California's not going to get the $80 million, with the factory or without it." California would not repeal the tax on machinery and equipment; New Mexico got the plant.

[48] See Besley and Rosen, op. cit.

[49] In some cases, transactions that appear to be business-to-business turn out to be business-to-consumer. For example, a hobby farmer needs many of the same business inputs as a commercial farmer. Thus, the hobby farmer is able to take advantage of the same sales tax exclusions as the commercial farmer. Such cases are rare, however, and therefore are not accounted for in this sub-index.

[50] Sales taxes that are levied on stages of production are known as value-added taxes (VAT) and are popular internationally because they attempt to neutralize the negative economic impact of tax pyramiding. The VAT has never gained wide acceptance in the U.S., and only one state (Michigan) has even attempted a VAT-like tax.

[51] New Mexico's score is improved by its business exclusion for farmers and ranchers.

[52] South Dakota has a gross receipts tax base, but businesses "have the right" to pass the tax onto the consumer via a complex refund formula. Depending on how many businesses bother to exercise their "right" to pass the tax onto consumers, this could be called either a sales tax or a gross receipts tax. States that use the term "sales tax" may actually have a gross receipts tax and vice-versa. This makes identification difficult, but the structure of the index is designed to reflect the level of tax pyramiding within a state's sales tax.

[53] On top of its 4% state rate, Virginia levies a uniform and standard 1 percent "local option" tax for the entire state.

[54] The local option sales tax rate is calculated on a weighted average basis. Each county rate is weighted by its percentage of total state personal income.

to the sales tax rate and the tax base. The rate sub-index is calculated using two criteria: the state-level rate and the combined state-local rate. States will score well if they either do without a sales tax or if the combined state and local sales tax rate is low. The ideal base for sales taxation is all goods and services at the point of sale to the end user.[49]

States that create the most tax pyramiding and economic distortion, and therefore score the worst, are states that levy a sales tax that generally allows no exclusions for business inputs.[50] Hawaii, New Mexico,[51] Washington and South Dakota[52] are examples of states that tax many business inputs. Selective sales taxes, or excise taxes, are taxes levied on specific goods. Goods that are typically perceived as vices, such as cigarettes and alcohol, and those that are not subject to large changes in demand when their prices increase, such as gasoline, are the most likely to be subject to excise taxes. The Sales Tax Index takes into account the excise tax rates each state levies.

The five states without a state sales—Alaska, Delaware, New Hampshire, Oregon, and Montana—achieve the best scores on this index. For states with a sales tax, Virginia has the best score because it does a good job of avoiding tax pyramiding and maintains low excise tax rates. Other states that score well include Georgia, Maryland, South Carolina and Massachusetts. They tend to have average or below-average tax rates, exempt most business input items from sales tax, and maintain low or moderate excise taxes.

At the other end of the spectrum, Washington levies its sales tax on most business inputs—such as services, manufacturing, and leases—and maintains relatively high excise taxes. Joining Washington at the bottom are New York, Tennessee, Nevada and New Mexico. Tennesse has the highest combined state and local rate of 10.4 percent. These states levy high sales tax rates that apply to most or all business input items. See Table 5 for state rankings.

Sub-Index #1: Sales Tax Rate

The tax rate itself is important, and a state with a high sales tax rate reduces demand for in-state retail sales. Consumers will turn more frequently to out-of-state, catalog, or internet purchases, leaving less business activity in state. This sub-index measures the highest possible sales tax rate applicable to in-state retail shopping and taxable business-to-business transactions. Four states—Delaware, Montana, New Hampshire and Oregon—do not have a general state sales tax and thus are given a rate of zero. Alaska is generally counted among states with no sales tax since it does not levy a statewide sales tax. However, Alaska localities are allowed to levy sales taxes and the weighted average of county and municipal taxes is 3.14 percent.

The SBTCI measures the state and local sales tax rate in each state. A combined rate is computed by adding the general state rate to the weighted average of the county and municipal rates. The 2007 Index is the first edition of the Index to include municipal rates.

STATE SALES TAX RATE

Of the states with a statewide sales tax, Colorado's 2.9 percent rate is lowest. Seven states have a 4 percent state-level sales tax: Alabama, Georgia, Louisiana, New York, South Dakota, Virginia[53] and Wyoming.

The states with the worst score in this sub-index are Tennessee, Mississippi and Rhode Island with their 7 percent statewide rates (New Jersey enacted a 7 percent rate two weeks after the 2007 fiscal year started). Other states with high statewide rates include Nevada, Washington and Minnesota (6.5 percent) and Texas, Illinois and California (6.25 percent).

LOCAL OPTION SALES TAX RATES

State-level sales taxes are only part of the story. Thirty-two states authorize the use of local option sales taxes at the county and/or municipal level.[54] Local jurisdictions in Colorado, for example, add 1.61 percent in local sales taxes to the state's 2.9 percent state-level rate, bringing the total sales tax rate to 4.51 percent. This may be an understatement in some localities with much higher local add-ons, but by using the weighted average for each state's local rates, the index makes the states comparable. In some states, the local option sales tax significantly increases the tax rate faced by consumers.

Louisiana not only has the highest local option sales tax (4.32 percent), but its weighted average for local rates actually exceeds the state sales tax rate of 4 percent. New York has the second highest local option sales taxes (4.24 percent), which are also greater than the state tax rate of 4 percent. Other states with high local option sales taxes include Tennessee (3.14 percent), Alaska (3.14 percent), Nevada (2.93 percent) and Alabama (2.67 percent).

The sub-index adds the state and local sales taxes together and then grades them on the combined rate. States with the highest combined rates are Tennessee (10.4 percent), Nevada (9.43 percent), Washington (8.49 percent), Louisiana (8.32 percent) and New York (8.24 percent). At the low end

Table 5
Sales Tax Index and Ranking, 2003, 2004, 2006 and 2007

	FY 2007 Sales Tax Index		FY 2006 Sales Tax Index		Change from 2006 to 2007		FY 2004 Sales Tax Index		FY 2003 Sales Tax Index Score	
State	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
Alabama	5.35	21	5.28	21	0.07	0	5.24	21	5.18	24
Alaska	9.30	3	9.63	1	– 0.33	– 2	9.51	1	9.50	3
Arizona	4.48	43	4.49	42	– 0.02	– 1	4.43	44	4.18	44
Arkansas	4.65	38	4.67	39	– 0.02	1	4.66	37	5.06	27
California	4.61	39	4.68	38	– 0.07	– 1	4.63	38	4.45	42
Colorado	5.07	28	5.12	24	– 0.05	– 4	5.18	22	5.48	17
Connecticut	4.87	33	4.83	34	0.04	1	4.80	34	4.78	36
Delaware	9.55	2	9.53	3	0.02	1	9.45	3	9.51	1
Florida	5.40	17	5.41	18	– 0.01	1	5.44	18	5.40	18
Georgia	6.12	7	6.33	6	– 0.21	– 1	6.30	7	6.30	7
Hawaii	5.10	26	5.11	25	0.00	– 1	5.08	27	5.00	30
Idaho	4.80	36	4.76	35	0.04	– 1	4.75	36	5.19	23
Illinois	4.96	32	5.09	26	– 0.13	– 6	5.05	28	5.37	20
Indiana	5.80	13	5.81	13	– 0.01	0	6.27	8	6.25	8
Iowa	5.37	19	5.38	19	– 0.01	0	5.39	19	5.33	21
Kansas	5.12	25	4.97	32	0.15	7	4.78	35	4.94	33
Kentucky	5.83	11	5.88	10	– 0.05	– 1	6.08	9	5.59	15
Louisiana	4.11	45	4.01	45	0.10	0	3.80	46	3.71	47
Maine	5.72	14	5.72	14	0.01	0	5.81	14	5.78	13
Maryland	6.10	8	6.08	8	0.03	0	6.07	10	6.00	9
Massachusetts	5.87	10	5.86	12	0.01	2	5.84	12	5.73	14
Michigan	5.68	15	5.68	15	0.00	0	5.65	15	5.54	16
Minnesota	4.61	40	4.60	40	0.00	0	4.56	40	4.45	43
Mississippi	4.68	37	4.68	37	0.00	0	4.56	39	4.46	41
Missouri	5.80	12	5.87	11	– 0.07	– 1	5.87	11	5.83	11
Montana	9.26	5	9.21	5	0.05	0	9.20	4	9.33	4
Nebraska	4.39	44	4.36	44	0.03	0	4.44	43	4.60	39
Nevada	3.56	47	3.36	49	0.20	2	3.29	49	3.19	49
New Hampshire	9.59	1	9.61	2	– 0.02	1	9.51	2	9.51	2
New Jersey	5.00	29	5.04	29	– 0.04	0	5.12	24	5.06	26
New Mexico	3.97	46	3.96	46	0.00	0	4.11	45	4.09	45
New York	3.50	49	3.48	48	0.02	– 1	3.52	47	3.37	48
North Carolina	4.48	42	4.51	41	– 0.03	– 1	4.52	41	4.56	40
North Dakota	5.26	22	5.28	22	– 0.02	0	5.28	20	5.20	22
Ohio	4.50	41	4.45	43	0.04	2	4.44	42	4.85	35
Oklahoma	4.86	34	5.01	30	– 0.15	– 4	5.10	26	5.01	29
Oregon	9.27	4	9.24	4	0.02	0	9.08	5	9.07	5
Pennsylvania	5.18	23	5.09	27	0.10	4	5.00	29	4.95	32
Rhode Island	4.82	35	4.74	36	0.08	1	4.81	33	4.74	37
South Carolina	5.92	9	5.91	9	0.01	0	5.83	13	5.79	12
South Dakota	4.99	30	4.97	31	0.02	1	4.96	31	4.92	34
Tennessee	3.51	48	3.49	47	0.02	– 1	3.42	48	3.75	46
Texas	4.96	31	4.92	33	0.04	2	4.84	32	4.73	38
Utah	5.16	24	5.20	23	– 0.04	– 1	5.10	25	5.01	28
Vermont	5.49	16	5.54	16	– 0.05	0	5.50	16	5.94	10
Virginia	6.29	6	6.30	7	– 0.01	1	6.72	6	6.71	6
Washington	3.23	50	3.25	50	– 0.02	0	3.15	50	2.99	50
West Virginia	5.36	20	5.31	20	0.05	0	5.46	17	5.39	19
Wisconsin	5.09	27	5.09	28	0.01	1	5.00	30	4.95	31
Wyoming	5.39	18	5.43	17	– 0.04	– 1	5.16	23	5.18	25
District of Columbia	4.19	-	4.22	-	– 0.03	-	4.20	-	4.17	-

Note: States without a sales or gross receipts tax rank equally as number 1.
Scores from 2003 and 2004 are calendar year, 2006 and 2007 are fiscal year.
Source: Tax Foundation

are Hawaii (4 percent), Colorado (4.5 percent) and South Dakota (4.8 percent).

Another difficulty businesses face with some local option sales taxes is that not only do rates differ, but some states also allow localities to define their own sales tax base, multiplying complexity for businesses and consumers. These states are Colorado, Idaho and New York.

Sub-Index #2: Sales Tax Base

The sales tax base sub-index is computed according to three features of each state's sales tax: (1) whether the base includes a variety of business-to-business transactions such as agricultural products, services,

machinery, computer software, and leased or rented items; (2) whether the base includes goods and services typically purchased by consumers; and (3) the excise tax rate on products such as gasoline, diesel fuel, tobacco, spirits and beer.

The top five states on this sub-index are those without a general sales tax—Alaska, New Hampshire, Delaware, Oregon and Montana. None receives a perfect score because they all levy gasoline, diesel, tobacco, and beer excise taxes. For the states that do have a general sales tax, Virginia, Kentucky, Missouri, Indiana and Georgia have the highest scores. These states avoid the problems of tax pyramiding and have low excise tax rates.

On the other hand, the states with the worst scores on the base sub-index are New Mexico, Hawaii, Washington, South Dakota and Nebraska. As a result, their tax systems are hampering economic growth due to the inclusion of too many business inputs, the exclusion of too many consumer goods and services, and/or excessive rates of excise taxation.

The extent of business-to-business sales taxation is measured by tallying exemptions for six categories of intermediate goods and services. The categories of business purchases tallied by this sub-index are: agricultural inputs, service inputs, manufacturing and machinery inputs, computer and software inputs, leasing and rental inputs, and pollution control equipment. Second, exemptions from the sales tax base of groceries and gasoline are included since the best sales tax system is one that offers the fewest exemptions for consumer products and services, even for staples such as groceries and gas. Finally, because excise taxes single out products for extra taxes, essentially the mirror image of a tax exemption, they are tallied in this sub-index as well.

BUSINESS INPUTS

These variables are often inputs to other business operations. For example, a manufacturing firm will count the cost of transporting its final goods to retailers as a significant cost of doing business. Most firms, small and large alike, hire accountants, lawyers, and other professional service firms. If these services are taxed, then it is more expensive for every business to operate.

Note that these inputs should only be exempt from sales tax if they are truly inputs into the production process. If they are consumed by an end user, they are properly includable in the state's sales tax base.

Agricultural Inputs
- Insecticides and pesticides
- Fertilizer, seed and feed
- Seedlings, plants and shoots

Service Inputs
- Cleaning services
- Transportation services
- Repair services
- Professional/personal services
- General treatment

Manufacturing and Machinery Inputs
- Manufacturing machinery
- Utilities
- Farm machinery
- Raw material
- Office equipment

Computer and Software Inputs
- Custom software
- Modified canned software
- Downloaded software

Leasing and Rental Inputs
- Motor vehicles
- Rooms and lodging
- All other tangible personal property

Pollution Control Equipment
- Air pollution control equipment
- Water pollution control equipment

CONSUMER GOODS AND SERVICES

State sales tax bases should include all goods and services purchased by the end users of those products. Exempting any goods or services narrows the tax base, drives up the sales tax rate, and introduces unnecessary distortion into the market.

Gasoline

Purchases of gasoline should be included in the sales tax base, even though every state subjects gasoline to a separate excise levy at the distributor stage of production. Ideally, the excise tax can be viewed as a user fee that funds road construction, and where this is the case, no damaging tax pyramiding is caused by levying both an excise and a general sales tax on gasoline. There is no economic reason to exclude gasoline from the sales tax base since the sales tax is intended to apply broadly to

Michigan

Michigan businesses have 15 more months of exposure to the state's notorious Single Business Tax, which it has repealed as of January 1, 2008. It ranks as the most punitive tax on corporations in the country, and its presence drags down Michigan's overall ranking down to 27th.

all consumption. Thus, the Index gives a better score to states that include gasoline in the sales tax base.

Nine states include gasoline in their sales tax base: California, Florida, Georgia, Hawaii, Illinois, Indiana, Michigan, New York and West Virginia.

Groceries

A principled approach to sales tax policy calls for all end-user goods to be included in the tax base, to keep the base broad, rates low, and prevent distortions in the marketplace. Should groceries be the exception?

Many state officials will say that they exempt groceries in order to make the sales tax system easier on low-income people. In reality, exempting groceries from the sales tax mostly benefits grocers, not the poor, although even grocers have occasion to complain because the maintenance of complex, ever-changing lists of exempt and non-exempt products constitutes an administrative burden for all concerned. Most importantly, though, widespread availability of public assistance for the purchase of groceries—in the form of welfare or the food-stamp program—makes the argument for such exemptions unpersuasive.

Fifteen states include or partially include groceries in their sales tax base. Illinois, Missouri and Virginia partially include groceries, while Alabama, Arkansas, Hawaii, Idaho, Kansas, Mississippi, Oklahoma, South Carolina, South Dakota, Tennessee, Utah and West Virginia wholly include groceries in the sales tax base.

EXCISE TAXES

Excise taxes are single-product sales taxes. Many of them are intended to reduce consumption of the product bearing the tax. Others, like the gasoline tax, are often used to fund specific projects like road construction. The sub-index tallies:

- Gasoline excise tax
- Diesel excise tax
- Tobacco excise tax
- Beer excise tax
- Spirits excise tax

Gasoline and diesel excise taxes (levied on a per gallon basis) are usually levied on the benefit principle as a means to pay for road construction and maintenance. Since gasoline represents a large input for most businesses, states that levy higher rates have a less competitive business tax climate. States with the highest gasoline taxes are New York (36.9 cents), Wisconsin (33.9 cents), Pennsylvania (31.2 cents) and Washington and Rhode Island (31 cents). States with the lowest gasoline taxes are Alaska (8 cents), Wyoming (14 cents) and New Jersey (14.5 cents). States with the highest diesel taxes are Pennsylvania (38.1 cents), Wisconsin (32.9 cents) and Rhode Island and Washington (31 cents), while states with the lowest diesel taxes are Alaska (8 cents) and Oklahoma and Wyoming (14 cents).

Tobacco, spirits and beer excise taxes are mostly problematic because they discourage in-state consumption and encourage consumers to seek lower prices in neighboring jurisdictions (Moody and Warcholik, 2004).This impacts a wide swath of retail outlets, such as convenience stores, that move large volumes of tobacco and beer products. The problem is exacerbated for those retailers located near the border of states with lower excise taxes as consumers move their shopping out of state—referred to as cross-border shopping.

In addition to cross-border shopping, there is also the growing problem of cross-border smuggling of products from states that levy low excise taxes on tobacco into states that levy high excise taxes on tobacco. This both increases criminal activity and reduces taxable sales by legitimate retailers (Fleenor, 1998).

States with the highest tobacco taxes per pack of 20 cigarettes are Rhode Island ($2.46), New Jersey ($2.40) and Washington ($2.025), while states with the lowest tobacco taxes are South Carolina (7 cents), Missouri (17 cents) and Mississippi (18 cents). States with the highest beer taxes on a per gallon basis are Alaska ($1.07), Hawaii (93 cents) and South Carolina (77 cents), while states with the lowest beer taxes are Wyoming (2 cents), Missouri (6 cents) and Wisconsin (6 cents). States with the highest spirits taxes per gallon are Washington ($21.15), Oregon ($17.77) and Alabama ($14.78).

[55] The federal government levies its own UIT called the Federal Unemployment Tax Act (FUTA) with a rate of 6.2 percent on wages up to $7,000. However, the federal government provides a tax credit worth up to 5.4 percent of the wage base. As a result, the lowest state maximum rate is 5.4 percent in order to maximize the use of the federal tax credit. Therefore, the effective federal rate is a much lower 0.8 percent and is used predominantly to offset the administrative costs associated with oversight of the unemployment trust fund.

[56] Eighteen states adjust their taxable wage base: Arkansas, Hawaii, Idaho, Iowa, Louisiana, Minnesota, Montana, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Utah, Virginia, Washington and Wyoming. States often make this adjustment on an annual basis, and it is generally based on the growth of wages. The effect in the Index is a continual erosion of these states' scores as their taxable wage bases grow relative to states that have a static taxable wage base.

UNEMPLOYMENT INSURANCE TAX INDEX

The fourth index is the Unemployment Insurance Tax (UIT) index. UITs are paid by employers into the Unemployment Insurance program to finance benefits for workers recently unemployed. Unlike the other major taxes assessed in the State Business Tax Climate Index, UITs are much less well known, every state has one, and there are no perfect or even nearly perfect UIT systems. All are complex, variable-rate systems that impose different rates on different industries and different bases depending upon such factors as the health of the state's UI trust fund.

One of the worst aspects of the UIT system is that financially troubled businesses, where layoffs may be a matter of survival, actually pay higher marginal rates as they are forced into higher tax rate schedules. In the academic literature, this has long been called the "shut-down effect" of UI taxes: failing businesses face climbing UI taxes, with the result that they fail sooner.

The Unemployment Insurance Tax Index consists of two sub-indexes, one that measures each state's rate structure and one that focuses on the tax base. Each is weighted to represent half of the total index score.

Overall, the states with the least damaging UITs are Oklahoma, Mississippi, Florida, North Carolina and Vermont. Comparatively speaking, these states have rate structures with lower minimum and maximum rates and a wage base at the federal level. In addition, they have simpler experience formulas and charging methods, and they have not complicated their systems with benefit add-ons and surtaxes.

On the other hand, the states with the worst UITs are Rhode Island, Massachusetts, Kentucky, Idaho and New York. These states tend to have rate structures with high minimum and maximum rates and wage bases above the federal level. Moreover, they have more complicated experience formulas and charging methods, and they have added benefits and surtaxes to their systems (see Table 6). The Unemployment Insurance Tax Index is weighted 14.2 percent of a state's final SBTCI score. See Tables 18, 19 and 20 in the appendix for details of each state's system.

Sub-Index #1: Unemployment Insurance Tax Rate

UIT rates in each state are based on a schedule ranging from a minimum rate to a maximum rate. The schedule for any particular business is dependent upon the business' experience rating. The rate is then applied to a taxable wage base (a predetermined fraction of an employee's wage) to determine UIT liability.

Overall, the states with the best score on this sub-index are Florida, Mississippi, Virginia, North Carolina and Louisiana. Generally, these states have low minimum and maximum tax rates on each schedule and a wage base at or near the federal level. States with the worst scores are Massachusetts, Rhode Island, Minnesota, North Dakota and Maryland.

The sub-index gives equal weight to two factors: the actual rates levied in the most recent year, and the statutory rate schedules that can potentially be implemented at any time depending on the state of the economy and the UI fund.

TAX RATES IMPOSED IN THE MOST RECENT YEAR

Minimum Tax Rate

States with the best scores in this variable are Georgia, Hawaii, Iowa, Missouri, North Carolina, South Dakota and Wisconsin, all of which had a minimum rate of zero. On the other end of the spectrum, the highest rates and, thus, the worst scores are found in Rhode Island (1.69 percent), West Virginia (1.5 percent), California (1.3 percent), South Carolina (1.24 percent) and Alabama (1.21 percent).

Maximum Tax Rate

Fifteen states receive the highest scores in this variable because they have a relatively low tax rate of 5.4 percent.[55] The states are: Alaska, Arizona, California, Colorado, Connecticut, Florida, Hawaii, Idaho, Maine, Mississippi, Nevada, New Jersey, New Mexico and Oregon. States with the highest rates and, thus, the worst scores on this variable are Minnesota (11 percent), Massachusetts (10.96 percent), Ohio (10.8 percent) and Michigan (10.3 percent).

Taxable Wage Base[56]

Ten states receive the best score in this variable with a taxable wage base of $7,000—in line with the federal taxable wage base. The states with the highest taxable bases and, thus, the worst scores in this variable are Hawaii ($34,000), Washington ($30,900), Idaho ($29,200), Alaska ($28,700) and Oregon ($28,000).

States with the best UIT rate systems are Arizona, Florida, Louisiana, Mississippi and Virginia. They have low minimum and maximum rates and a low taxable wage base. The states with the worst scores are Rhode Island, Minnesota, Massachusetts, North Dakota and Utah. These

Table 6
Unemployment Insurance Tax Index and Ranking, 2003, 2004, 2006 and 2007

	FY 2007 Unemployment Insurance Tax Index		FY 2006 Unemployment Insurance Tax Index		Change from 2006 to 2007		CY 2004 Unemployment Insurance Tax Index		CY 2003 Unemployment Insurance Tax Index	
State	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
Alabama	6.07	8	6.23	4	– 0.16	– 4	6.04	6	6.04	7
Alaska	3.84	45	3.91	43	– 0.07	– 2	4.30	38	4.25	39
Arizona	5.97	10	5.91	12	0.07	2	6.01	8	6.21	4
Arkansas	4.50	35	4.05	41	0.45	6	4.06	45	4.89	30
California	5.50	18	5.50	20	0.00	2	5.37	22	5.66	14
Colorado	5.21	23	5.27	21	– 0.06	– 2	5.16	25	5.32	23
Connecticut	5.65	16	5.01	26	0.64	10	5.17	24	5.03	27
Delaware	6.00	9	5.95	11	0.06	2	5.88	10	5.71	12
Florida	6.50	3	6.62	1	– 0.12	– 2	6.53	1	6.57	2
Georgia	4.70	32	4.64	32	0.05	0	4.56	33	4.47	36
Hawaii	5.19	24	5.24	22	– 0.05	– 2	5.41	20	5.30	24
Idaho	3.50	47	3.68	46	– 0.19	– 1	3.83	46	3.66	47
Illinois	4.47	36	4.34	37	0.13	1	4.18	42	4.25	38
Indiana	5.56	17	6.05	7	– 0.49	– 10	6.07	5	6.16	5
Iowa	5.02	27	4.96	28	0.06	1	4.98	28	4.77	31
Kansas	5.78	12	5.72	15	0.07	3	5.62	17	5.55	17
Kentucky	3.35	48	3.35	48	0.00	0	3.45	47	3.34	48
Louisiana	5.96	11	6.01	9	– 0.04	– 2	5.39	21	6.00	8
Maine	4.01	42	3.98	42	0.03	0	4.28	40	4.11	42
Maryland	4.77	30	5.63	17	– 0.86	– 13	5.75	14	5.37	21
Massachusetts	2.75	49	2.76	49	– 0.01	0	3.07	48	3.83	46
Michigan	4.23	41	4.18	40	0.05	– 1	4.18	41	4.15	41
Minnesota	4.36	39	4.55	35	– 0.19	– 4	4.67	32	4.61	32
Mississippi	6.64	2	6.58	2	0.05	0	6.51	2	6.39	3
Missouri	6.09	7	6.02	8	0.07	1	6.00	9	5.55	16
Montana	5.22	21	5.16	24	0.06	3	5.21	23	5.14	26
Nebraska	5.10	26	5.73	14	– 0.63	– 12	5.65	16	5.62	15
Nevada	4.29	40	4.26	38	0.04	– 2	4.28	39	5.49	18
New Hampshire	3.95	44	3.91	44	0.04	0	4.08	43	3.98	45
New Jersey	5.14	25	4.99	27	0.14	2	5.09	26	4.96	28
New Mexico	5.67	15	5.60	18	0.07	3	5.74	15	5.69	13
New York	3.62	46	3.62	47	0.00	1	2.34	50	2.45	49
North Carolina	6.20	4	6.13	5	0.07	1	6.02	7	5.99	9
North Dakota	4.38	38	4.46	36	– 0.08	– 2	4.42	37	4.24	40
Ohio	5.35	19	5.88	13	– 0.53	– 6	5.87	11	5.96	10
Oklahoma	6.75	1	6.43	3	0.32	2	6.39	3	6.74	1
Oregon	4.90	29	4.77	30	0.12	1	4.99	27	5.18	25
Pennsylvania	5.77	13	5.71	16	0.05	3	5.83	12	4.04	43
Rhode Island	2.18	50	2.33	50	– 0.14	0	2.66	49	2.26	50
South Carolina	3.96	43	3.87	45	0.09	2	4.06	44	4.04	44
South Dakota	4.75	31	4.70	31	0.05	0	4.74	30	4.48	35
Tennessee	4.67	33	4.60	33	0.07	0	4.53	34	4.37	37
Texas	6.10	6	6.06	6	0.03	0	5.81	13	5.85	11
Utah	5.26	20	5.21	23	0.05	3	5.42	19	5.45	19
Vermont	6.10	5	5.99	10	0.11	5	6.24	4	6.09	6
Virginia	5.22	22	5.16	25	0.05	3	4.93	29	4.93	29
Washington	4.45	37	4.24	39	0.21	2	4.44	36	5.37	22
West Virginia	4.66	34	4.57	34	0.09	0	4.49	35	4.49	34
Wisconsin	5.01	28	4.95	29	0.06	1	4.72	31	4.54	33
Wyoming	5.68	14	5.53	19	0.15	5	5.58	18	5.44	20
District of Columbia	5.01	-	4.96	-	0.05	-	5.05	-	5.07	-

Scores from 2003 and 2004 are calendar year, 2006 and 2007 are fiscal year.
Source: Tax Foundation

states generally have high minimum and maximum rates and a high taxable wage base.

POTENTIAL RATES

Due to business and seasonal cycles, all the businesses in each state will probably be forced to change UIT rate schedules at some point each year. When UIT trust funds are flush, businesses will trend toward the most favorable rate schedules; however, when UI trust funds are low, businesses will trend toward the least favorable rate schedules. Not only are the rates themselves important from a neutrality perspective, but states with a large differential between the minimum and maximum rates are less neutral than states with smaller differentials.

MOST FAVORABLE TAX RATE SCHEDULE

Minimum Tax Rate Schedule
Seventeen states receive the best score in this variable with a minimum tax rate of zero, which they levy when unemployment is low and the UI fund is flush. The states with the highest minimum tax rates and thus the worst scores are Alaska (1 percent), Massachusetts (0.8 percent), Rhode Island (0.6 percent), South Carolina (0.54 percent) and Oregon, Maine and Connecticut (0.5 percent).

Maximum Tax Rate Schedule
Twenty-four states receive the best score in this variable with a comparatively low maximum tax rate of 5.4 percent. The states with the highest maximum tax rates and thus the worst maximum tax scores are North Dakota (10.09 percent), Tennessee (10 percent), Arkansas (9.9 percent), Kentucky (9 percent) and Minnesota (9.0 percent).

LEAST FAVORABLE TAX RATE SCHEDULE

Minimum Tax Rate Schedule
Five states receive the best score in this variable with a minimum tax rate of zero percent: Iowa, Missouri, North Carolina, Texas and Wyoming. The states with the highest minimum tax rates and, thus, the worst minimum tax scores are Arizona (2.85 percent), New Hampshire (2.8 percent), New Mexico (2.7 percent), Washington (2.47 percent) and Maine (2.4 percent).

Maximum Tax Rate Schedule
Twelve states receive the best score in this variable with a comparatively low maximum tax rate of 5.4 percent. The states with the highest maximum tax rates and, thus, the worst maximum tax scores are Massachusetts (15.4 percent), Maryland (13.5 percent), Arkansas and Georgia (10.8 percent), Pennsylvania (10.59 percent) and South Dakota (10.5 percent).

Overall, the states with the best scores on their potential statutory UIT rates are North Carolina, Florida, Mississippi, Texas and Virginia. North Carolina gets a perfect 10, with all of its potential rates at the lowest rates. The other top states follow the same pattern with slight deviations. The states with the worst scores are Massachusetts, Maryland, Rhode Island, Kentucky, Arkansas and Maine. Many of these states have double-digit maximum tax rates.

Sub-Index #2: Unemployment Insurance Tax Base

The UIT base sub-index scores states on how they determine which businesses should pay the UIT and how much, as well as other UI-related taxes for which businesses may also be liable.
The states that receive the best scores on this sub-index are Oklahoma, Delaware, Vermont, Utah, and Mississippi. In general, these states have relatively simple experience formulas, they exclude more factors from the charging method, and they enforce fewer surtaxes.

States that receive the worst scores are Rhode Island, Idaho, New Hampshire, New York and Nevada. In general, they have more complicated experience formulas, exclude fewer factors from the charging method, and have complicated their systems with add-ons and surtaxes. The three equally weighted factors considered in this sub-index are experience rating formulas, charging methods, and a host of smaller factors aggregated into one variable.

Mississippi

The Achilles heel of Mississippi's tax system is the sales tax. In the other four major tax areas, Mississippi excels, with two top-ten rankings and two above-average. Although it doesn't permit local options, Mississippi has a 7 percent state sales tax rate, tied for the nation's highest, and it applies that rate to many business-to-business transactions.

EXPERIENCE RATING FORMULA

A business's experience rating formula determines the rate the firm must pay—whether they will lean towards the minimum rate or maximum rate of the given rate schedule.

There are four basic experience formulas— contribution, benefit, payroll and state experience. The first three experience formulas—the contribution, benefit and payroll—are based solely on the business's experience and are therefore non-neutral by design. However, the final variable—state experience—is a positive mitigating factor because it is based on statewide experience. In other words, the state experience is not tied to the experience of any one business; therefore, it is a more neutral factor. This sub-index penalizes states that depend on the contribution, benefit and payroll experience variables while rewarding states with the state experience variable.

CHARGING METHODS AND BENEFITS EXCLUDED FROM CHARGING

A business' experience rating will vary depending on which charging method the state government uses. When a former employee applies for unemployment benefits, the benefits paid to the employee must be

charged to a previous employer. There are three basic charging methods:

1. Charging Most Recent or Principal Employer: Thirteen states charge all the benefits to one employer, usually the most recent.

2. Charging Base-Period Employers in Inverse Chronological Order: Six states charge all base-period employers in inverse chronological order. This means that all employers within a base period of time (usually the last year, sometimes longer) will have the benefits charged against them with the most recent employer being charged the most.

3. Charging in Proportion to Base-Period Wages: Thirty-one states charge in proportion to base period wages. This means that all employers within a base-period of time (usually the last year, sometimes longer) will have the benefits charged against them in proportion to the wages they paid.

None of these charging methods could be called neutral, but at the margin, charging the most recent or principal employer is the least neutral because the business faced with the necessity of laying off employees knows it will bear the full benefit charge. The most neutral of the three is the "charging in proportion to base-period wages" since there is a higher probability of sharing the benefit charges with previous employers.

As a result, the 31 states that charge in proportion to base-period wages receive the best score. The 13 states that charge the most recent or principal employer receive the worst score. The six that charge base-period employers in inverse chronological order receive a median score.

Many states also recognize that certain benefit costs should not be charged to employers, especially if the separation is beyond the employer's control. Therefore, this sub-index also accounts for six types of exclusions from benefit charges.

1. Benefit award reversed
2. Reimbursements on combined wage claims
3. Voluntary leaving
4. Discharge for misconduct
5. Refusal of suitable work
6. Continues to work for employer on part-time basis

States are rewarded for each of these exclusions because they nudge a UI system toward neutrality. For instance, if benefit charges were levied by employees that voluntarily quit, then industries with high turnover rates, such as retail, would be hit disproportionately harder. States that receive the best scores in this category are Ohio, Utah, Vermont, Oregon, Louisiana, Delaware and Arizona. Ohio receives a perfect score by charging in proportion to base-period wages and including all six benefit exclusions. On the other hand, the states that receive the worst scores are Alaska, New Hampshire, Kentucky, Nevada, New York and Rhode Island. All but Alaska charge the most recent or principal employer and forbid most benefit exclusions.[57]

OTHER SIGNIFICANT ISSUES

Five of the eight variables in this catch-all category of the sub-index deal with taxes levied on top of the UIT. Not all were triggered during 2006, but states are penalized in this sub-index if they are on the books.

Overall, the states that receive the best scores in this category are Vermont, Oklahoma, New Mexico, North Carolina, Michigan, Maine and Kansas. Idaho, New Jersey, Oregon and Rhode Island scored the worst.

Solvency Tax

These taxes are levied on employers when a state's unemployment fund falls below some defined level. Twenty states have a solvency tax on the books though they fall under different names, such as Solvency Adjustment Tax (Alaska), Supplemental Assessment Tax (Delaware), Emergency Tax (New Hampshire), Subsidiary Tax (New York), Minimum Safe Level Tax (Ohio) and Fund Building Tax (Virginia).

Taxes for Socialized Costs or Negative Balance Employer

These are levied on employers when the state desires to recover benefit costs above and beyond the UIT collections based on the normal experience rating process. Thirty-two states have these taxes on the books though they fall under different names: Shared Cost Assessment Tax (Alabama), Nonchargeable Benefits Compound Tax (Michigan), Adverse Rating Tax (New Hampshire) and Graduated Social Cost Factor Rate Tax (Washington).

Loan and Interest Repayment Surtaxes

Levied on employers when a loan is taken from the federal government or when bonds are sold to pay for benefit costs, these taxes are of two general types. The first is a tax to pay off the federal loan or bond issue. The second is a tax to pay the interest on the federal loan or bond issue. States are not allowed to pay interest costs directly from the state's unemployment trust fund. Twenty-one states have

these taxes on the books though they fall under several names such as: Advance Interest Tax and Bond Assessment Tax (Colorado), Temporary Emergency Assessment Tax (Delaware) and Unemployment Obligation Assessment (Texas), to name a few.

Reserve Taxes
Reserve taxes are levied on employers to be deposited in a reserve fund separate from the unemployment trust fund. Since the fund is separate, the interest earned on it is often used to create other funds for purposes such as job training and/or paying the costs of the reserve tax's collection. Four states have these taxes on the books: Nebraska (State UI tax), Oregon (Supplemental Employment Department Tax), Idaho (Reserve Tax) and North Carolina (Reserve Fund Tax).

Surtaxes for UI Administration or Non-UI Purposes
Twenty-nine states levy surtaxes on employers, usually to fund administration but sometimes for job training or special improvements in technology. They are often deposited in a fund outside of the state's unemployment fund. Some of the names they go by are Job Training Assessment Tax (Arizona), Social Charge Rate Tax (Louisiana), Reemployment Service Fund Tax (New York), Wage Security Tax (Oregon), Investment South Dakota Future Fee Tax (South Dakota) and Job Skills Fee (Tennessee).

Temporary Disability Insurance
A handful of states—California, New Jersey, Rhode Island, Hawaii and New York—have established a temporary disability insurance (TDI) program that augments the UI program by extending benefits to those unable to work because of sickness or injury. No separate tax funds them; the money comes right out of the state's unemployment fund, and because the balance of the fund triggers various taxes, the TDIs are included as a negative factor in the calculation of this sub-index.

Voluntary Contributions
Twenty-seven states allow businesses to make voluntary contributions to the unemployment trust fund. In most cases, these contributions are rewarded with a lower rate schedule, often saving the business more money in taxes than was paid through the contribution. The Index rewards states that allow voluntary contributions because firms are able to pay when they can best afford to instead of when they are struggling. This provision helps to mitigate the non-neutralities of the UI tax.

Time-Period to Qualify for Experience Rating
Newly formed businesses, naturally, do not qualify for an experience rating because they simply have not been around long enough. Federal rules stipulate that states can levy a "new employer" rate for one to three years, but no less than one year. From a neutrality perspective, however, this new employer rate is non-neutral in almost all cases since the rate is lower than the lowest rate schedule. The longer this rate is in effect, the worse the non-neutrality. As such, the Index rewards states with the minimum one year required to earn an experience rating and penalizes states that require the full three years.

PROPERTY TAX INDEX

The Property Tax Index is the fifth and final component index that comprises the 2007 State Business Tax Climate Index. The Property Tax Index is comprised of taxes levied on the wealth of individuals and businesses. These include taxes on real and personal property, net worth, and the transfer of assets.

Real and personal property taxes are increasingly important to business because the booming real estate market of recent years has driven real property values higher, thereby increasing property valuations and taxes owed to localities and states. Property taxes are a major concern to businesses because they constitute a considerable cost of doing business and significantly impact location decisions. Other taxes included in the index are inheritance taxes, estate taxes, capital stock taxes and gift taxes.

Real and personal property taxes are a contentious subject at the state and local level as individuals and businesses protest rising tax bills caused by revaluations of residential and business property. In fact, for the second straight year, the Tax Foundation's Annual Survey of Tax Attitudes found that local property taxes are perceived as the least fair state or local tax.[58] Taxes increase as property

[57] Alaska is the only state not to use benefit payments in its formula but instead the variation in an employer's payroll from quarter to quarter. This is an extreme violation of tax neutrality since any decision by the employer or employee that would affect payroll may trigger higher UIT rates. As a result, Alaska scores the worst of all states in this sub-index.

[58] Andrew Chamberlain and Scott A. Hodge, "2006 Annual Survey of U.S. Attitudes on Tax and Wealth," *Tax Foundation Special Report,* No. 141.

values rise unless new, higher assessments are matched by a decrease in the rate.

Property taxes are important to businesses because they are a substantial cost of doing business, and with increasing property valuations, businesses are paying higher and higher tax bills, especially because the tax rate on commercial property is generally higher than on residential property. Additionally, localities and states often levy taxes on the personal property or equipment owned by a business. Since property taxes can be a large burden to business, they can have a significant effect on location decisions.

Mark, McGuire and Papke (2000) find taxes that vary from one location to another within a region could be more important determinants of intraregional location decisions. They find that higher rates of two business taxes—the sales tax and the personal property tax—are associated with lower employment growth. They estimate that a tax hike on personal property of one percentage point reduces annual employment growth by 2.44 percentage points (Mark et al. 2000).

New Mexico

New Mexico has improved several aspects of its tax system in recent years, with the result that its sales tax system is practically the only thing dragging its overall ranking down to a middle-of-the pack 23rd best. Although the rate is not excessive, its application to business-to-business transactions is among the most extensive in the nation. This results in several layers of sales taxation, which distorts the economy against sectors that rely on multiple stages of production to bring their products to market.

Personal property taxes are levied on assets of individuals and business. They can be on assets ranging from cars to machinery and equipment to office furniture and fixtures, but are separate from real property taxes which are taxes on land and buildings. These findings provide strong evidence that personal property taxes greatly impact business decisions. Furthermore, these findings suggest that states competing for business would be well served to keep statewide property taxes low so as to be more attractive to business investment. Localities competing for business can put themselves at greater competitive advantage by keeping personal property taxes low as well.

Bartik (1985), finding that property taxes are a significant factor in business location decisions, estimates that a 10 percent increase in business property taxes decreases the number of new plants opening in a state by between 1 and 2 percent. Bartik (1989) backs up his earlier findings by concluding that higher property taxes negatively affect small business starts. He elaborates that the particularly strong negative effect of property taxes occurs because they are paid regardless of profits, and many small businesses are not profitable in their first few years, so high property taxes would be more influential than profit-based taxes on the start-up decision.

Businesses remitted $497 billion in state and local taxes in fiscal year 2005, of which 37 percent or $182.8 billion was for property taxes. The property taxes included tax on real, personal, and utility property owned by business (Cline et al 2006). Obviously property taxes are a significant cost to business. Coupled with the academic findings that property taxes are the most influential tax in terms of impacting location decisions by businesses, the evidence supports the conclusion that property taxes are a significant factor in a state's business tax climate.

Property taxes are not the only factor included in the Property Tax Index. Taxes on capital stock, intangible property, inventory, real estate transfers, estates, inheritance, generation-skipping transfers, and gifts are also included.

The states that score the best on the Property Tax Index are New Mexico, Utah, Idaho, North Dakota and Delaware. These states generally have low rates of property tax whether measured per capita or as a percentage of income. Also, they avoid distortionary taxes like estate, inheritance, gift and other wealth taxes. States that score poorly on the index are Rhode Island, Connecticut, Vermont, Ohio and New Jersey. These have high property tax rates and they generally levy several wealth-based taxes (see Table 7).

The Property Tax Index is comprised of two equally weighted sub-indexes devoted to measuring the economic damage of the rates and the tax bases. The rate sub-index consists of property tax collection—measured both per capita and as a percentage of personal income—capital stock tax rates and maximum payments. The base portion consists of dummy variables detailing whether each state levies wealth taxes such as inheritance, estate, gift, inventory, intangible property and other similar taxes. The entire Property Tax Index is weighted 15.72 percent of each state's overall State Business Tax Climate score. See Tables 21 and 22 for details of each state's property taxes.

Sub-Index #1: The Property Tax Rate

The property tax rate sub-index consists of property tax and capital stock tax sub-indexes. Property taxes are measured by collections per capita and as a percentage of personal income. They are weighted equally and receive 80 percent of the weight of the rate sub-index because of their importance to businesses and individuals and their increasing size and visibility to all taxpayers. States that score the best on the rate

sub-index are New Mexico, Hawaii, Kentucky, Alabama and Oklahoma. These states generally have low property tax collections per capita and low effective rates, a low capital stock tax rate or none at all (like Hawaii and New Mexico) and a small maximum capital stock tax payment. Conversely, states that score poorly have high property tax collections per capita and high effective rates, high capital stock tax rates and high or no maximum payments. These states include Vermont, Rhode Island, New Jersey, Connecticut and New Hampshire.

PROPERTY TAX COLLECTIONS AND RATES

The property tax rate sub-index is weighted 50 percent for each section: property tax collections per capita and property tax collections as a percent of personal income. Both are included to gain a better understanding of how much each state collects in proportion to its population and its income. Tax collections as a percentage of personal income forms an effective rate that gives taxpayers a sense of how much of their income is devoted to property taxes, and the per capita figure lets them know how much in actual dollar terms they pay in property taxes compared to residents of other states.

While these measures are not ideal—having effective tax rates of personal and real property for both businesses and individuals would be ideal—they are the best measures available due to the significant data constraints posed by property tax collections. Since a high percentage of property taxes are levied on the local level, there are countless jurisdictions. The sheer number of different localities makes data collection almost impossible. The few studies that tackle the subject use representative towns or cities instead of the entire state. Thus, the best source for data on property taxes is the Census Bureau since it can compile the data and reconcile definitional problems.

States that maintain low effective rates and low collections per capita are more likely to promote growth than states with high rates and collections. States that score the best on this sub-index have low collections per capita and low effective rates. They include Alabama, Arkansas, New Mexico, Oklahoma and Delaware. States that score poorly have high collections per capita and high effective rates and include Vermont, New Jersey, New Hampshire, Maine and Connecticut.

Property Tax Collections Per Capita

Property tax collections per capita are calculated by dividing property taxes collected in each state (obtained from the Census Bureau) by population. The states that pay the most property tax per capita are New Jersey ($2,163), Vermont ($2,042), Connecticut ($2,007), New Hampshire ($1,885) and New York ($1,726). The states that collect the least per capita are Alabama ($382), Arkansas ($399), New Mexico ($451), Oklahoma ($481) and Louisiana ($524).

Effective Property Tax Rate

Property tax collections as a percent of personal income are derived by dividing the Census Bureau's figure for total property tax collections by personal income in each state. This provides an effective property tax rate. States with the highest effective rates and therefore the worst scores are Vermont (5.83 percent), Maine (4.99 percent), New Jersey (4.68 percent), New Hampshire (4.57 percent) and Rhode Island (4.44 percent). States that score well with low effective rates are Alabama (1.24 percent), Arkansas (1.40 percent), Delaware (1.43 percent), New Mexico (1.55 percent) and Oklahoma (1.56 percent).

CAPITAL STOCK TAXES

Capital stock taxes (commonly called franchise taxes) are levied on the wealth of a corporation, usually defined as net worth. They are often levied in addition to corporate income taxes, adding a duplicate layer of taxation and compliance for many corporations. Corporations that find themselves in financial trouble must use precious cash flow to pay their capital stock tax. In assessing capital stock taxes, the sub-index accounts for three variables: the capital stock tax rate, maximum payment and capital stock tax versus corporate income tax dummy variable. The capital stock tax sub-index is 20 percent of the total rate sub-index.

Capital Stock Tax Rate

This variable measures the rate of taxation as levied by the 22 states with a capital stock tax. States with the highest capital stock tax rate include Delaware (9 percent), West Virginia (7 percent), Pennsylvania (4.89 percent), Ohio (4 percent) and Connecticut (3.1 percent).

Maximum Capital Stock Tax Payment

Ten states mitigate the negative economic impact of the capital stock tax by placing a cap on the maximum capital stock tax payment. These states include Alabama, Arkansas, Connecticut, Delaware, Georgia, Illinois, Kansas, Nevada, North Carolina and Oklahoma, and they receive the highest score on this variable.

Table 7
Property Tax Index and Ranking, 2003, 2004, 2006 and 2007

	FY 2007 Property Tax Index		FY 2006 Property Tax Index		Change from 2006 to 2007		CY 2004 Property Tax Index		CY 2003 Property Tax Index	
State	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
Alabama	5.61	15	6.34	7	– 0.73	– 8	6.29	7	6.08	8
Alaska	5.55	17	5.48	19	0.07	2	5.35	20	5.06	23
Arizona	5.67	12	5.68	15	– 0.01	3	5.63	15	5.42	15
Arkansas	5.96	9	6.09	10	– 0.12	1	5.97	11	5.72	12
California	5.61	16	6.24	8	– 0.63	– 8	6.20	8	6.01	9
Colorado	5.52	18	5.57	16	– 0.05	– 2	5.53	16	5.37	16
Connecticut	2.81	49	2.12	50	0.70	1	2.59	50	2.56	50
Delaware	6.32	5	6.48	5	– 0.16	0	6.41	5	6.20	6
Florida	4.80	31	4.76	29	0.04	– 2	4.75	30	4.64	31
Georgia	5.24	23	5.26	22	– 0.03	– 1	5.26	22	5.14	21
Hawaii	6.31	6	6.42	6	– 0.11	0	6.37	6	6.18	7
Idaho	6.84	3	6.90	3	– 0.06	0	6.83	3	6.62	3
Illinois	4.20	40	4.13	39	0.07	– 1	4.15	39	4.58	33
Indiana	4.89	29	4.90	28	0.00	– 1	4.77	28	4.50	34
Iowa	4.74	33	4.70	31	0.03	– 2	4.62	32	4.49	35
Kansas	4.64	34	4.60	33	0.05	– 1	4.74	31	4.76	30
Kentucky	5.72	11	4.65	32	1.07	21	4.59	33	4.42	36
Louisiana	5.10	25	5.22	23	– 0.13	– 2	5.20	23	5.06	24
Maine	4.23	39	4.07	40	0.16	1	4.01	40	4.39	37
Maryland	3.85	41	3.87	41	– 0.02	0	3.85	42	4.22	41
Massachusetts	3.70	43	3.67	43	0.04	0	3.66	45	4.11	43
Michigan	4.53	35	4.94	26	– 0.41	– 9	5.11	24	5.13	22
Minnesota	5.66	14	5.70	14	– 0.03	0	5.66	14	5.78	10
Mississippi	5.30	21	5.36	21	– 0.06	0	4.78	27	5.15	20
Missouri	5.86	10	5.95	12	– 0.09	2	5.90	12	5.69	13
Montana	5.19	24	5.12	24	0.07	0	5.07	25	4.89	26
Nebraska	3.53	45	3.45	46	0.08	1	3.46	47	3.89	46
Nevada	5.67	13	5.71	13	– 0.05	0	5.71	13	5.57	14
New Hampshire	4.75	32	4.33	37	0.41	5	4.33	37	3.75	47
New Jersey	3.35	46	3.16	47	0.19	1	3.18	48	3.68	48
New Mexico	7.51	1	7.69	1	– 0.18	0	7.63	1	7.35	1
New York	3.74	42	3.60	45	0.13	3	3.87	41	4.25	40
North Carolina	4.40	38	4.27	38	0.14	0	4.22	38	4.63	32
North Dakota	6.64	4	6.67	4	– 0.04	0	6.65	4	6.37	5
Ohio	3.16	47	3.12	48	0.04	1	3.73	44	4.10	44
Oklahoma	5.43	20	5.56	18	– 0.13	– 2	5.51	17	5.32	17
Oregon	6.05	8	6.07	11	– 0.02	3	6.01	10	6.37	4
Pennsylvania	3.70	44	3.66	44	0.05	0	3.64	46	4.10	45
Rhode Island	2.70	50	2.54	49	0.16	– 1	2.64	49	3.21	49
South Carolina	4.92	28	4.93	27	– 0.01	– 1	4.95	26	4.86	27
South Dakota	6.12	7	6.18	9	– 0.06	2	6.07	9	5.75	11
Tennessee	4.41	37	4.50	34	– 0.08	– 3	4.41	35	4.20	42
Texas	4.49	36	4.43	36	0.07	0	4.41	34	4.29	38
Utah	7.01	2	7.10	2	– 0.09	0	7.07	2	6.87	2
Vermont	3.07	48	3.76	42	– 0.70	– 6	3.81	43	4.27	39
Virginia	4.98	26	4.43	35	0.55	9	4.39	36	4.81	28
Washington	4.92	27	4.96	25	– 0.04	– 2	5.44	19	5.26	18
West Virginia	5.47	19	5.56	17	– 0.09	– 2	5.51	18	4.77	29
Wisconsin	4.82	30	4.73	30	0.08	0	4.75	29	5.19	19
Wyoming	5.30	22	5.37	20	– 0.08	– 2	5.31	21	4.95	25
District of Columbia	4.37	-	4.53	-	– 0.16	-	4.73	-	4.74	-

Scores from 2003 and 2004 are calendar year; 2006 and 2007 are fiscal year.
Source: Tax Foundation

Capital Stock Tax versus Corporate Income Tax

Some states mitigate the negative economic impact of the capital stock by allowing corporations to pay the higher of the two taxes. These states include Connecticut, New York and Texas, and they receive the highest score on this variable. States that do not have a capital stock get the best scores in this sub-index while the remaining nineteen states that force companies to pay both scored the lowest.

Sub-Index #2: The Property Tax Base

The property tax base sub-index is 50 percent of the total Property Tax Index and is composed of

dummy variables listing the different types of property taxes each state levies. Seven taxes are included and each is equally weighted. Wyoming, Utah, North Dakota, New Mexico and Idaho receive perfect scores because they do not levy any of the seven taxes. Maryland, Ohio, Connecticut, Massachusetts, Nebraska, North Carolina, Pennsylvania, Rhode Island and Tennessee score worst because they impose many of the taxes.

PROPERTY TAXES

Intangible Property Tax

This dummy variable punishes those states that impose taxes on intangible personal property. Intangible personal property includes things such as stocks, bonds and other intangibles such as trademarks. This tax can be highly harmful to businesses that hold large amounts of their own or other companies' stock and that have valuable trademarks. Only five states levy this punitive tax: Alabama, Florida[59], Mississippi, Ohio and Pennsylvania.

Inventory Tax

Levied on the value of a company's inventory, the inventory tax is especially harmful to large retail stores and other businesses that store large amounts of merchandise. Inventory taxes are highly distortionary because they force companies to make decisions about production that are not entirely based on economic principles, but rather on how to pay the least amount of tax on goods produced. Inventory taxes also create strong incentives for companies to locate inventory in states where they can avoid these harmful taxes. Sixteen states levy inventory taxes.

ASSET TRANSFER TAXES

Five taxes levied on the transfer of assets are part of the Property Tax Index base. These taxes all increase the cost and complexity of transferring wealth and hurt a state's business climate. These harmful effects can be particularly acute in the case of small, family-owned businesses. The five taxes are real estate transfer taxes, estate taxes, inheritance taxes, generation-skipping taxes and gift taxes. Thirty-five states levy taxes on the transfer of real estate, adding to the cost of purchasing real property and increasing the complexity of real estate transactions. This tax is harmful to businesses that transfer real property often.

The 2001 federal tax cut, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), phased out the federal estate tax by 2010, and lowered its rate in the intervening years, although it will be reinstated in 2011 in the same form as it existed in 2001. Before the phase-out, most states levied an estate tax that piggy-backed on the federal system. Since the federal system allowed for a credit for state estate taxes paid, the federal government was essentially paying the states' estate tax collections, and individuals did not object because their tax liability was unchanged. When the federal government changed its system, states began to decouple to save a substantial source of revenue. The 32 states that have allowed the state death tax credit to expire without decoupling from the federal system or enacting their own estate tax get a positive score. The federal credit was completely phased out as of 2005. Eighteen states have decoupled from the federal system to maintain the revenue stream of estate taxes by either reverting to pre-EGTRAA rules or creating their own stand-alone system. These states are punished for increasing complexity.

Each year some businesses, especially those that have not spent a sufficient sum on estate tax planning and on large insurance policies, find themselves unable to pay their estate taxes, either federal or state. Usually they are small-to-medium sized family-owned businesses where the death of the owner occasions a surprisingly large tax liability.

Inheritance taxes are similar to estate taxes, but they are levied on the heir of an estate, instead of on the estate itself. Therefore, a person could inherit a family-owned company from his or her parents and be forced to downsize it, or sell part or all of it in order to pay the heir's inheritance tax. Ten states have inheritance taxes and are punished because the inheritance tax causes economic distortions.

Another estate-style tax, the generation-skipping tax, is imposed on people when they bequeath assets to grandchildren. The twenty-eight states that have such a tax score poorly. Similarly, five states, California, Connecticut, Louisiana, North Carolina and Tennessee, have a gift tax and score poorly. Gift taxes are designed to stop individuals' attempts to

Pennsylvania

Pennsylvania's systems for taxing individual income and unemployment insurance are among the nation's best, but bad taxes on business and property drag the state's overall ranking down to 22nd. Its corporate tax ranks only 42nd best, and the principal culprit is the 9.9% rate. Only Iowa has enacted a higher corporate tax rate. Its poor showing on the Property Tax Index is not so much due to real estate taxes, but to several taxes on assets that other states avoid. The planned phase-out of the capital stock tax will help.

[59] Florida repealed their Intangibles tax in August 2006 effective January 1, 2007.

avoid the estate tax by giving their estates away before they die. Generation-skipping and gift taxes are negatives to a state's business tax climate because they also heavily impact individuals who have sole proprietorships, S-corps and LLCs.

Conclusion

The purpose of the Tax Foundation's State Business Tax Climate Index is to aid business leaders and government policymakers in their determination of whether a state's tax system enhances or harms the competitiveness of the state's business environment. The economic literature shows that taxes do matter a great deal, and the Index reduces many complex considerations to an easy-to-use ranking. But businesses must grapple with a wide assortment of other issues, such as proximity to consumers, raw materials or a highly educated labor pool. These concerns may seem more important than a good tax system, but taxes can positively or negatively affect a business's position with regard to these very resources.

While taxes are a fact of life, not all tax systems are created equal. States should strive to create tax systems that have a broad base and a low rate. Ultimately, that means that states must strive for tax systems that are economically neutral—systems that do not favor one economic activity over another—and systems that promote economic growth—by avoiding excessive taxes on business activities and keeping the cost of complying with the tax system as low as possible.

The 2007 State Business Tax Climate Index highlights those factors that make states' tax climates more or less competitive than other states' tax climates. States that score poorly can use the Index to pinpoint the improvements that would enhance their competitiveness the most. States that score well can also use the Index to determine where they gain a competitive advantage and work to strengthen their advantage in those areas, or work to improve the factors on which they do not score as well.

In a highly competitive global market, states need to make their tax systems friendly to business in order to facilitate the expansion and growth of business. A simple tax system that is fair to all businesses is the best way for states to have a competitive business tax climate.

Changes to Methodology

Each year the methodology of the State Business Tax Climate Index is altered to better measure the impact of taxes on state-level economies. Therefore, each year the SBTCI becomes a more accurate assessment tool. Each time the methodology of the SBTCI is altered, the change is projected back to previous years, creating a new set of rankings for the present year and previous years that are comparable to one another. States lawmakers and citizens are then able to chart their state's progress over time. The following are the major changes between the 2006 and 2007 SBTCI.

Gross receipts taxes are a growing trend in states as lawmakers look for new and more stable means of raising revenue. Kentucky, Ohio and Texas are the three states that enacted gross receipts taxes in the last two years. Washington, Michigan and Delaware already had such taxes on the books and until recently New Jersey did as well. It is possible that the revival of this once discredited tax will continue.

A gross receipts tax section has been added to the Corporate Tax Index. States with gross receipts taxes are scored on the highest tax rate levied, although some states levy many different rates. States with alternative assessments—Kentucky and, until 2007, New Jersey—are scored half on their gross receipts taxes and half on their corporate income taxes. States that require their corporate taxpayers to pay both types of tax each year, Delaware and Ohio (through 2009), are penalized the most by the introduction of gross receipts taxes to the SBTCI.

Also in the Corporate Tax Index, a category for credits and deductions was added to the base subindex. States are penalized if they offer job tax credits, research and development tax credits, or investment tax credits. This reinforces the theme of the SBTCI that state tax systems with broad bases and low rates are the best. States that offer fewer credits have a broader base that ultimately allows a lower rate.

States receive a lower score if they do not offer full deductibility of wages and cost of goods sold. Most states rely on regular corporate income taxes where these deductions are never in question, but they are not always deductible in the few states with gross receipts taxes, especially Washington.

The Individual Income Tax Index was strengthened by adding local option income taxes. Thanks

to data from Commerce Clearing House and the Census Bureau, all county-level income tax rates and all large municipal income tax rates are added to the state-level rate. In all, 13 states have local rates added on to their top state income tax rate.

Similarly, municipal sales tax rates have been added to state and county taxes.

In the base sub-index of the Sales Tax Index, exemptions for gasoline and groceries are punished as economically damaging distortions. States that include groceries and gasoline in their sales tax base maintain larger bases, permitting them to maintain a lower rate.

Lastly, in the excise tax category, excise taxes on distilled spirits were added as new data from the Distilled Spirits Council of the U.S. permitted us to compare states with government-run wholesale or retail sectors—the so-called control states—to the taxes levied in states with private sector systems of liquor distribution and sales.

Appendix 1: Tax Laws Enacted During Fiscal Year 2007

The 2007 State Business Tax Climate Index depicts each state's tax system as it stood on July 1, 2006 — the first day of the 2007 fiscal year. Choosing a snapshot date is necessary, but of course tax laws change constantly, so we note here the changes that have occurred since then and which have not been calculated in the ranking. Because more than a hundred tax laws go into each state's score, only major changes can move a state's overall ranking. Also, no definite claims can be made about how a particular state change could affect a future ranking because other states may improve or damage their business tax climates in the meantime.

RECENT CHANGES LIKELY TO IMPROVE A STATE'S TAX CLIMATE

Arizona: Arizona is in the middle of a two-year individual income tax cut that will see its top rate cut from 5.04 percent to 4.54 percent in 2007. As of July 1, 2006, the rate in place was 4.79 percent. Assuming the final cut is permitted to take effect, Arizona's score on the Individual Income Tax Index would improve, possibly causing it to rise in the ranking as well.

Florida: Effective January 1, 2007, Florida will repeal its tax on intangible personal property. This tax on stocks, bonds, notes and other intangible property is part of the Property Tax Index, and its repeal will help Florida's score in that component index.

Michigan: After a prolonged and heated debate, the Michigan legislature finally repealed the Single Business Tax (SBT), effective at the end of calendar year 2007. Michigan currently ranks last in the Corporate Tax Index because of the SBT, which resembles a gross receipts tax in many respects. Its repeal, though 15 months away, could greatly improve Michigan's score, assuming the SBT is replaced by a well designed, broad-based tax.

New Mexico: New Mexico has slowly cut its top individual income tax rate, from 6 percent in 2004 to 5.7 percent in 2005 to 5.3 percent as of July 1, 2006. If the rate continues to drop as scheduled, reaching 4.9 percent in 2008, New Mexico's score will continue to improve on the Individual Income Tax Index, the most heavily weighted component of the SBTCI.

North Carolina: North Carolina cuts its state-level sales tax rate to 4.25 percent from 4.5 percent and its top individual income tax rate from 8.25 percent to 8 percent. If these are still in place on July 1, 2007, with no countervailing rate hikes elsewhere, North Carolina's scores and rankings are likely to improve.

Oklahoma: Oklahoma is reducing its top individual income tax rate from 6.25 percent to 5.25 percent by 2010. It is also repealing its estate tax over a three-year period. Each year's State Business Tax Climate Index will rank Oklahoma on the level of the rate each July 1.

Pennsylvania: The continued phase-out of Pennsylvania's capital stock tax will improve the business tax climate. Starting at the original rate of 11 mills (1.1%) in 1998, the tax will be completely phased out in 2011. The rate at the beginning of the 2007 fiscal year was 4.89 mills (0.489%) which went into this edition's calculation. The current schedule of annual reductions indicates that at the beginning of each of the next several fiscal years, it will be 3.89 mills, then 2.89 mills, then1.89 mills and in its last year, 2010, 0.89 mills. These rate reductions promise steadily improved rankings in the Property Tax Index.

RECENT CHANGES LIKELY TO HURT A STATE'S TAX CLIMATE

Hawaii: Hawaii's cigarette tax on July 1, 2006, was $1.40 per pack. It has enacted a 20-cent per year increase over the next six years, which will bring its rate to $2.60 in 2011. Cigarette taxes are counted in the Sales Tax Index, and Hawaii will get a lower score each year. Unless other states raise their rates even faster, Hawaii's ranking could fall as well.

Idaho: The state sales tax rate has bounced back and forth between 5 and 6 percent over the last several years. The legislature raised the rate from 5 to 6 percent in 2003, promising that the hike was temporary and would be dropped back down to 5 percent after two years. In fact, two years later state coffers were in surplus, and lawmakers permitted the rate to drop on schedule, amid much self-congratulation. The lower rate didn't last long, however, and a year later the legislature approved a permanent hike to 6 percent, effective October 1, 2006.

The average combined state-local sales tax rate in the country is 5.85 percent, so the movement of Idaho's rate from below-average to above-average will hurt its ranking in the Index.

Kansas: Kansas implemented its own stand-alone estate tax effective January 1, 2007. This will lower Kansas's score on the Property Tax Index and its overall score.

New Jersey: The much publicized budget battle in New Jersey resulted in a tax increase for the already tax saturated residents of New Jersey. Most importantly, New Jersey's sales tax increased one full percent on July 15, 2006, to 7 percent from 6 percent. This increase will hurt New Jersey's score in the Sales Tax Index and its overall score.

Texas: In order to comply with a court ruling on school financing Texas completely overhauled its tax system. It implemented a gross receipts tax, called the Margins Tax at 1 percent (0.5 percent for retailers) on Texas businesses. Also included in the tax overhaul were property tax cuts and a cigarette tax increase. Overall, any benefits from property tax cuts are likely to be overwhelmed by damage to the tax climate caused by the other changes. The new gross receipts tax may address equity issues that marred the reputation of the old franchise tax, but it will introduce other problems and is likely to result in a lower ranking for the state.

RECENT CHANGES WITH UNCERTAIN RESULTS FOR THE TAX CLIMATE

Ohio: Ohio repealed its traditional corporate income tax in favor of a gross receipts tax, but both the repeal and the enactment are phased in over several years. In 2010, if the schedule is unchanged, the state will once again have only one business tax, the new Commercial Activities Tax, but in the intervening years, it will have two. Although trumpeted as a major tax reform that would help the Ohio business tax climate, these claims appear unrealistic. Certainly, during the transition period when businesses must deal with both of them, Ohio will continue to rank below most other states on the Corporate Tax Index, a major component of the overall State Business Tax Climate Index.

More promising are Ohio's prospects on two other components of the SBTCI, the Individual Income Index and the Property Tax Index. Ohio has enacted substantial cuts in its individual income tax rates, and it is phasing out its tangible personal property tax on inventory, manufacturing machinery and equipment and furniture and fixtures. Both will improve the state tax climate.

Rhode Island: The only major tax law enacted before July 1, 2006, that is not accounted for in this year's edition is Rhode Island's new optional income tax. No other state permits any taxpayers to calculate their liability two ways and pay the least, although Utah is contemplating just such a measure. Rhode Island residents, those with annual income over $250,000, now have the option to calculate their tax liability using the regular rates and brackets or using the new one-rate flat tax that permits no deductions or exemptions. The new rate is 8 percent in 2006, and it is unclear how many taxpayers will benefit though the number will undoubtedly be small. However, current law calls for this optional rate to drop a little each year until it reaches 5.5 percent in 2011. If the reductions occur as scheduled, the number of taxpayers complying with the new flat tax will grow, and its impact will be registered in the State Business Tax Climate Index.

South Carolina: South Carolina passed a major tax bill that reduces property taxes but increases the state's sales tax to 6 percent from 5 percent. The law is effective July 1, 2007.

Appendix 2: Components of the State Business Tax Climate Index

Table 8
State Corporate Tax Rates, as of July 1, 2006

State	Corporate Income Tax Rates and Brackets			Gross Receipts Tax Rate (a)
Alabama	6.5%	>	$0	
Alaska	1%	>	$0	
	2%	>	$10,000	
	3%	>	$20,000	
	4%	>	$30,000	
	5%	>	$40,000	
	6%	>	$50,000	
	7%	>	$60,000	
	8%	>	$70,000	
	9%	>	$80,000	
	9.4%	>	$90,000	
Arizona	6.968%	>	$0	
Arkansas	1%	>	$0	
	2%	>	$3,000	
	3%	>	$6,000	
	5%	>	$11,000	
	6%	>	$25,000	
	6.5%	>	$100,000	
California	8.84%	>	$0	
Colorado	4.63%	>	$0	
Connecticut	9% (c)	>	$0	
Delaware	8.7%	>	$0	0.576%
Florida	5.5%	>	$0	
Georgia	6%	>	$0	
Hawaii	4.4%	>	$0	
	5.4%	>	$25,000	
	6.4%	>	$100,000	
Idaho	7.6%	>	$0	
Illinois	7.3%	>	$0	
Indiana	8.5%	>	$0	
Iowa	6%	>	$0	
	8%	>	$25,000	
	10%	>	$100,000	
	12%	>	$250,000	
Kansas	4%	>	$0	
	7.35%	>	$50,000	
Kentucky	4%	>	$0	0.095%
	5%	>	$50,000	
	7%	>	$100,000	
Louisiana	4%	>	$0	
	5%	>	$25,000	
	6%	>	$50,000	
	7%	>	$100,000	
	8%	>	$200,000	
Maine	3.5%	>	$0	
	7.93%	>	$25,000	
	8.33%	>	$75,000	
	8.93%	>	$250,000	
Maryland	7%	>	$0	
Massachusetts (b)	9.5%	>	$0	
Michigan		None		1.9%
Minnesota	9.8%	>	$0	
Mississippi	3%	>	$0	
	4%	>	$5,000	
	5%	>	$10,000	
Missouri	6.25%	>	$0	

Table 8 (continued)
State Corporate Tax Rates, as of July 1, 2006

State	Corporate Income Tax Rates and Brackets			Gross Receipts Tax Rate (a)
Montana	6.75%	>	$0	
Nebraska	5.58%	>	$0	
	7.81%	>	$50,000	
Nevada	None			
New Hampshire (d)	8.5%	>	$50,000	
	9.25%	>	$150,000	
New Jersey	6.5%	>	$0	
	7.5%	>	$50,000	
	9.36% (c)	>	$100,000	
New Mexico	4.8%	>	$0	
	6.4%	>	$500,000	
	7.6%	>	$1,000,000	
New York	7.5%	>	$0	
North Carolina	6.9%	>	$0	
North Dakota	2.6%	>	$0	
	4.1%	>	$3,000	
	5.6%	>	$8,000	
	6.4%	>	$20,000	
	7%	>	$30,000	
Ohio	4.08%	>	$0	0.104%
	6.8%	>	$50,000	
Oklahoma	6%	>	$0	
Oregon	6.6%	>	$0	
Pennsylvania	9.99%	>	$0	
Rhode Island	9%	>	$0	
South Carolina	5%	>	$0	
South Dakota	None			
Tennessee	6.5%	>	$0	
Texas (e)	None			
Utah	5%	>	$0	
Vermont	7%	>	$0	
	8.1%	>	$10,000	
	9.2%	>	$25,000	
	9.75%	>	$250,000	
Virginia	6%	>	$0	
Washington	None			0.484%
West Virginia	9%	>	$0	
Wisconsin	7.9%	>	$0	
Wyoming	None			
District of Columbia	9.98%	>	$0	

Note: Corporations pay many types of taxes, of which the corporate income tax is usually the most important for the business tax climate. However, some states levy other important business taxes such as the franchise tax and capital stock tax. Many of these are "wealth taxes" with a tax base consisting of capital assets, stocks, property, etc. The State Business Tax Climate Index tallies these in the Property Tax Index rather than in the Corporate Tax Index.

(a) Most states collect tax as a percentage of gross receipts from public utilities and some other sectors, and most states have a business license fee or other fixed dollar amount that all businesses must pay, and sometimes those are called gross receipts taxes. Shown here are only the states that tax all business broadly as a percentage of gross receipts.

(b) Massachusetts has a two-part corporate tax: a corporate income tax and a corporate franchise tax. The corporate income tax is levied on corporate profits and has a rate of 9.5 percent (including a 14 percent surtax), and this is the tax used in the Corporate Tax Index. Meanwhile, the corporate franchise tax, levied on taxable Massachusetts property or net worth at a rate of 0.26 percent, is tallied in the Property Tax Index.

(c) Connecticut's top rate is a statutory 7.5% rate plus a 20% surtax which adds to 9%. Similarly, New Jersey's top rate of 9.36% is the statutory 9% rate plus a 4% surtax.

(d) New Hampshire has a dual corporate income tax with differing tax bases—the business profit tax (BPT) and business enterprise tax (BET). The BPT has a rate of 8.5 percent if gross income is over $50,000 and the BET has a rate of 0.75 percent if gross income is over $150,000 or base (total compensation, interest and dividends paid) over $75,000. As a result, the top tax rate a corporation may face is the BPT rate plus the BET rate for a combined rate of 9.25 percent.

(e) Texas levies a 4.5 percent tax on taxable earned surplus or 0.25 percent tax on taxable capital. The tax liability is the greater of the two taxes. The 4.5 percent tax on taxable earned surplus is similar to a traditionally defined corporate income tax with the major difference being a larger tax base (federal net taxable income plus compensation paid to officers and directors of the corporation). The 0.25 percent tax on taxable capital is tallied in the property tax index, and in the Corporate Tax Index, Texas's 4.5 percent earned surplus tax rate is used.

Sources: Tax Foundation, Commerce Clearing House, state tax forms.

Table 9
Business Tax Base Criteria: Credits and Deductions, as of July 1, 2006

State	Job Credits	Research and Development Credits	Investment Credits	Compensation Expenses Deductible	Cost of Goods Sold Deductible
Alabama	Yes	No	Yes	Yes	Yes
Alaska	No	No	No	Yes	Yes
Arizona	Partial	Yes	Partial	Yes	Yes
Arkansas	Yes	Yes	Yes	Yes	Yes
California	No	Yes	No	Yes	Yes
Colorado	Yes	Partial	Yes	Yes	Yes
Connecticut	Partial	Yes	Yes	Yes	Yes
Delaware	Yes	Yes	Yes	Partial	Partial
Florida	Partial	Partial	Yes	Yes	Yes
Georgia	Partial	Yes	Yes	Yes	Yes
Hawaii	No	Yes	Partial	Yes	Yes
Idaho	Yes	Yes	Yes	Yes	Yes
Illinois	Yes	Yes	Yes	Yes	Yes
Indiana	Yes	Yes	Yes	Yes	Yes
Iowa	Yes	Yes	Yes	Yes	Yes
Kansas	Yes	Yes	Yes	Yes	Yes
Kentucky	Yes	Yes	Yes	Partial	Yes
Louisiana	Partial	Yes	Yes	Yes	Yes
Maine	Yes	Yes	Yes	Yes	Yes
Maryland	Yes	Yes	Partial	Yes	Yes
Massachusetts	Yes	Yes	Yes	Yes	Yes
Michigan	Partial	No	Partial	Partial	No
Minnesota	Yes	Yes	No	Yes	Yes
Mississippi	Yes	No	Partial	Yes	Yes
Missouri	Yes	Yes	Yes	Yes	Yes
Montana	No	Yes	Yes	Yes	Yes
Nebraska	Yes	Yes	Yes	Yes	Yes
Nevada	n.a.	n.a.	n.a.	n.a.	n.a.
New Hampshire	Yes	No	Yes	Yes	Yes
New Jersey	Yes	Yes	Yes	Yes	Yes
New Mexico	Yes	Yes	Yes	Yes	Yes
New York	Yes	Yes	Yes	Yes	Yes
North Carolina	Yes	Yes	Yes	Yes	Yes
North Dakota	No	Yes	Yes	Yes	Yes
Ohio	Yes	Yes	Yes	Partial	Partial
Oklahoma	Yes	Yes	Yes	Yes	Yes
Oregon	No	Yes	No	Yes	Yes
Pennsylvania	Yes	Yes	No	Yes	Yes
Rhode Island	Yes	Yes	Yes	Yes	Yes
South Carolina	Yes	Yes	No	Yes	Yes
South Dakota	n.a.	n.a.	n.a.	n.a.	n.a.
Tennessee	Yes	No	No	Yes	Yes
Texas	Yes	Yes	Yes	Yes	Yes
Utah	Partial	Yes	No	Yes	Yes
Vermont	Yes	Partial	Yes	Yes	Yes
Virginia	Yes	Partial	No	Yes	Yes
Washington	No	Yes	Partial	No	No
West Virginia	Yes	Yes	Yes	Yes	Yes
Wisconsin	No	Yes	Yes	Yes	Yes
Wyoming	n.a.	n.a.	n.a.	n.a.	n.a.
District of Columbia	Yes	No	Yes	Yes	Yes

Source: Commerce Clearing House.

Table 10
Other Business Tax Base Criteria, as of July 1, 2006

State	Carry-back (Years)	Carry-forward (Years)	Carry-back Cap	Carry-forward Cap
Alabama	0	15	$0	Unlimited
Alaska	2	20	$0	Unlimited
Arizona	0	5	$0	Unlimited
Arkansas	0	5	$0	Unlimited
California	0	10	$0	Unlimited
Colorado	0	20	$0	Unlimited
Connecticut	0	20	$0	Unlimited
Delaware	2	20	$ 30,000	Unlimited
Florida	0	20	$0	Unlimited
Georgia	2	20	Unlimited	Unlimited
Hawaii	2	20	Unlimited	Unlimited
Idaho	2	20	$ 100,000	Unlimited
Illinois	0	12	$0	Unlimited
Indiana	2	20	Unlimited	Unlimited
Iowa	2	20	Unlimited	Unlimited
Kansas	0	10	$0	Unlimited
Kentucky	0	20	$0	Unlimited
Louisiana	3	15	Unlimited	Unlimited
Maine	0	20	$0	Unlimited
Maryland	2	20	Unlimited	Unlimited
Massachusetts	0	5	$0	Unlimited
Michigan	0	10	$0	Unlimited
Minnesota	0	15	$0	Unlimited
Mississippi	2	20	Unlimited	Unlimited
Missouri	2	20	Unlimited	Unlimited
Montana	3	7	Unlimited	Unlimited
Nebraska	0	5	$0	Unlimited
Nevada	n.a.	n.a.	n.a.	n.a.
New Hampshire	0	10	$0	$1,000,000
New Jersey	0	7	$0	Unlimited
New Mexico	0	5	$0	Unlimited
New York	2	20	$10,000	Unlimited
North Carolina	0	15	$ 0	Unlimited
North Dakota	0	20	$ 0	Unlimited
Ohio	0	20	$ 0	Unlimited
Oklahoma	2	20	Unlimited	Unlimited
Oregon	0	15	$ 0	Unlimited
Pennsylvania	0	20	$ 0	$2,000,000
Rhode Island	0	5	$ 0	Unlimited
South Carolina	0	20	$ 0	Unlimited
South Dakota	n.a.	n.a.	n.a.	n.a.
Tennessee	0	15	$0	Unlimited
Texas	0	5	$0	Unlimited
Utah	3	15	$1,000,000	Unlimited
Vermont	2	20	Unlimited	Unlimited
Virginia	2	20	Unlimited	Unlimited
Washington	3	20	Unlimited	Unlimited
West Virginia	2	20	$300,000	Unlimited
Wisconsin	0	15	$ 0	Unlimited
Wyoming	n.a.	n.a.	n.a.	n.a.
District of Columbia	0	20	$0	Unlimited

Source: Commerce Clearing House.

Table 11
Other Business Tax Base Criteria, as of July 1, 2006

State	Federal Income Used as State Tax Base	Allow Federal ACRS or MACRS Depreciation	Allow Federal Depletion	Throwback Rule	Foreign Tax Deductibility	Corporate AMT	Rates Indexed for Inflation
Alabama	Yes	Yes	No	Yes	Yes	No	Yes
Alaska	Yes	Yes	Partial	Yes	No	Yes	No
Arizona	Yes	Yes	Yes	No	No	No	Yes
Arkansas	No	Yes	Yes	Yes	Yes	No	No
California	Yes	No	Yes	Yes	No	Yes	Yes
Colorado	Yes	Yes	Yes	Yes	No	No	Yes
Connecticut	Yes	Yes	Yes	No	Yes	No	Yes
Delaware	Yes	Yes	Partial	No	Yes	No	Yes
Florida	Yes	Yes	Yes	No	Yes	Yes	Yes
Georgia	Yes	Yes	Yes	No	No	No	Yes
Hawaii	Yes	Yes	Yes	Yes	Yes	No	No
Idaho	Yes	Yes	Yes	Yes	Yes	No	Yes
Illinois	Yes	Yes	Yes	Yes	Yes	No	Yes
Indiana	Yes	Yes	Yes	Yes	No	No	Yes
Iowa	Yes	Yes	Partial	No	Yes	Yes	No
Kansas	Yes	Yes	Yes	Yes	No	No	No
Kentucky	Yes	Yes	Yes	No	No	Yes	No
Louisiana	Yes	Yes	Partial	No	Yes	No	No
Maine	Yes	Yes	Yes	Yes	Yes	Yes	No
Maryland	Yes	Yes	Yes	No	Yes	No	Yes
Massachusetts	Yes	Yes	Yes	Yes	No	No	Yes
Michigan	Yes	No	Yes	No	No	No	No
Minnesota	Yes	Yes	No	No	No	Yes	Yes
Mississippi	No	Yes	Yes	Yes	No	No	No
Missouri	Yes	Yes	Yes	Yes	Yes	No	Yes
Montana	Yes	Yes	Yes	Yes	No	No	Yes
Nebraska	Yes	Yes	Yes	No	Yes	No	No
Nevada	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
New Hampshire	Yes	Yes	Partial	Yes	No	No	No
New Jersey	Yes	Yes	Yes	No	No	No	No
New Mexico	Yes	Yes	Yes	Yes	Yes	No	No
New York	Yes	Yes	Yes	No	No	Yes	Yes
North Carolina	Yes	Yes	Partial	No	No	No	Yes
North Dakota	Yes	Yes	Yes	Yes	No	No	No
Ohio	Yes	Yes	Yes	No	Yes	No	No
Oklahoma	Yes	Yes	Yes	Yes	No	No	Yes
Oregon	Yes	Yes	No	Yes	No	No	Yes
Pennsylvania	Yes	Yes	Yes	No	No	No	Yes
Rhode Island	Yes	Yes	Yes	No	Yes	No	Yes
South Carolina	Yes	Yes	Yes	No	No	No	Yes
South Dakota	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tennessee	Yes	Yes	Yes	No	Yes	No	Yes
Texas	Yes	Yes	Partial	Yes	Yes	No	Yes
Utah	Yes	Yes	Yes	Yes	No	No	Yes
Vermont	Yes	Yes	Yes	Yes	Yes	No	No
Virginia	Yes	Yes	Yes	No	No	No	Yes
Washington	No	No	No	No	No	No	Yes
West Virginia	Yes	Yes	Yes	No	No	No	Yes
Wisconsin	Yes	Yes	No	Yes	Yes	No	Yes
Wyoming	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
District of Columbia	Yes	Yes	Yes	Yes	No	Yes	Yes

Source: Commerce Clearing House.

Table 12
Individual Income Tax Rates, as of July 1, 2006

State	Federal Deductibility	Tax Rates and Brackets for Single Filers (a)	Standard Deduction		Personal Exemptions (b)		Local Option Income tax Rate (v)
			Single	Joint	Single	Dependents	
Alabama	Yes (t)	2% > $0 4% > $500 5% > $3,000	$2,000	$4,000	$1,500	$300	0.19%
Alaska	No	None	n.a.	n.a.	n.a.	n.a.	None
Arizona	No	2.73% > $0 3.04% > $10,000 3.55% > $25,000 4.48% > $50,000 4.79% > $150,000	$4,125	$8,250	$2,100	$2,100	None
Arkansas (k)(r)	No	1% > $0 2.5% > $3,500 3.5% > $7,000 4.5% > $10,500 6% > $17,500 7% > $29,200	$2,000	$4,000	$21 (c)	$21 (c)	0.06%
California (r)	No	1.0 > $0 2% > $6,319 4% > $14,979 6% > $23,641 8% > $32,819 9.3% > $41,476 10.3% > $1,000,000	$3,254	$6,508	$87 (c)	$ 272 (c)	None
Colorado	No	4.63% of federal taxable income	n.a.	n.a.	n.a.	n.a.	None
Connecticut	No	3% > $0 5% > $10,000	n.a.	n.a.	$12,625 (e)	$0	None
Delaware	No	2.2% > $2,000 3.9% > $5,000 4.8% > $10,000 5.2% > $20,000 5.55% > $25,000 5.95% > $60,000	$3,250	$6,500	$110 (c)	$110 (c)	0.88%
Florida	No	None	n.a.	n.a.	n.a.	n.a.	None
Georgia	No	1% > $0 2% > $750 3% > $2,250 4% > $3,750 5% > $5,250 6% > $7,000	$2,300	$3,000	$2,700	$3,000	None
Hawaii	No	1.4% > $0 3.2% > $2,000 5.5% > $4,000 6.4% > $8,000 6.8% > $12,000 7.2% > $16,000 7.6% > $20,000 7.9% > $30,000 8.25% > $40,000	$1,500	$1,900	$1,040	$1,040	None

Table 12 (Continued)
Individual Income Tax Rates, as of July 1, 2006

State	Federal Deductibility	Tax Rates and Brackets for Single Filers (a)	Standard Deduction		Personal Exemptions (b)		Local Option Income tax Rate (v)
			Single	Joint	Single	Dependents	
Idaho (g) (r)	No	1.6% > $0 3.6% > $1,159 4.1% > $2,318 5.1% > $3,477 6.1% > $4,636 7.1% > $5,794 7.4% > $8,692 7.8% > $23,178	$5,000 (s)	$10,000 (s)	$3,200 (s)	$3,200 (s)	None
Illinois	No	3% of federal adjusted gross income with modification.	n.a.	n.a.	$2,000	$2,000	None
Indiana	No	3.4% of federal adjusted gross income with modification.	n.a.	n.a.	$1,000	$1,000 (l)	0.97%
Iowa (r)	Yes	0.36% > $0 0.72% > $1,270 2.43% > $2,539 4.5% > $5,077 6.12% > $11,422 6.48% > $19,036 6.8% > $25,381 7.92% > $38,071 8.98% > $57,106	$1,610	$3,970	$40 (c)	$40 (c)	None
Kansas	No	3.5% > $0 6.25% > $15,000 6.45% > $30,000	$3,000	$6,000	$2,250	$2,250	None
Kentucky	No	2% > $0 3% > $3,000 4% > $4,000 5% > $5,000 5.8% > $8,000 6% > $75,000	$1,910	$1,910	$ 20 (c)	$ 20 (c)	0.93%
Louisiana	Yes	2% > $0 4% > $12,500 6% > $25,000	n.a.	n.a.	$ 4,500 (l)	$1,000	None
Maine (r)	No	2% > $0 4.5% > $4,450 7% > $8,850 8.5% > $17,700	$5,000	$8,300	$2,850	$2,850	None
Maryland	No	2% > $0 3% > $1,000 4% > $2,000 4.75% > $3,000	$2,000 (m)	$4,000 (m)	$2,400	$2,400	2.73%
Massachusetts	No	5.3% and 12% (f)	n.a.	n.a.	$3,575	$1,000	None
Michigan	No	3.9% of federal adjusted gross income with modification	n.a.	n.a.	$3,200 (s)	$3,200 (s)	0.09%
Minnesota	No	5.35% > $0 7.05% > $19,890 7.85% > $65,330	$5,000 (s)	$10,000 (s)	$3,200 (s)	$3,200 (s)	None
Mississippi	No	3% > $0 4% > $5,000 5% > $10,000	$2,300	$4,600	$6,000	$1,500	None

Table 12 (Continued)
Individual Income Tax Rates, as of July 1, 2006

State	Federal Deductibility	Tax Rates and Brackets for Single Filers (a)	Standard Deduction		Personal Exemptions (b)		Local Option Income tax Rate (v)
			Single	Joint	Single	Dependents	
Missouri	Yes (u) (t)	1.5% > $0 2% > $1,000 2.5% > $2,000 3% > $3,000 3.5% > $4,000 4% > $5,000 4.5% > $6,000 5% > $7,000 5.5% > $8,000 6% > $9,000	$5,000 (s)	$10,000 (s)	$2,100	$1,200	0.38%
Montana (r)	Yes	1% > $0 2% > $2,300 3% > $4,100 4% > $6,200 5% > $8,400 6% > $10,800 6.9% > $13,900	$3,560	$7,120	$1,900	$1,900	None
Nebraska	No	2.56% > $0 3.57% > $2,400 5.12% > $17,000 6.84% > $26,500	$4,980	$8,320	$103 (c)(n)	$103 (c)(n)	None
Nevada	No	None	n.a.	n.a.	n.a.	n.a.	None
New Hampshire	No	5% > $0 (h)	n.a.	n.a.	$2,400	n.a.	None
New Jersey	No	1.4% > $0 1.75% > $20,000 3.5% > $35,000 5.525% > $40,000 6.37% > $75,000 8.97% > $500,000	n.a.	n.a.	$1,000	$1,500	0.09%
New Mexico	No	1.7% > $0 3.2% > $5,500 4.7% > $11,000 5.3% > $16,000	$5,000 (s)	$10,000 (s)	$3,200 (s)	$3,200 (s)	None
New York	No	4% > $0 4.5% > $8,000 5.25% > $11,000 5.9% > $13,000 6.85% > $20,000	$7,500	$14,600	n.a.	$1,000	0.62%
North Carolina	No	6% > $0 7% > $12,750 7.75% > $60,000 8.25% > $120,000	$3,000	$6,000	$1,200 (o)	$1,200 (o)	None
North Dakota (r)	No	2.1% > $0 3.92% > $29,700 4.34% > $71,950 5.04% > $150,150 5.54% > $326,450	$5,000 (s)	$10,000 (s)	$3,200 (s)	$3,200 (s)	None

Table 12 (Continued)
Individual Income Tax Rates, as of July 1, 2006

State	Federal Deductibility	Tax Rates and Brackets for Single Filers (a)	Standard Deduction		Personal Exemptions (b)		Local Option Income tax Rate (v)
			Single	Joint	Single	Dependents	
Ohio	No	0.652% > $0 1.3% > $5,000 2.6% > $10,000 3.26% > $15,000 3.91% > $20,000 4.56% > $40,000 5.22% > $80,000 6.05% > $100,000 6.58% > $200,000	n.a.	n.a.	$1,350 (g)	$1,350 (g)	1.74%
Oklahoma	Yes (d)	0.5% > $0 1% > $1,000 2% > $2,500 3% > $3,750 4% > $4,900 5% > $7,200 6.25% > $8,700	$2,000 (p)	$2,000 (p)	$1,000	$1,000	None
Oregon	Yes	5% > $0 7% > $2,600 9% > $6,500	$1,770	$3,545	$154 (c)(r)	$154 (c)(r)	0.64%
Pennsylvania	No	3.07% > $0	n.a.	n.a.	n.a.	n.a.	0.52%
Rhode Island	No	3.75% > $0 7% > $29,700 7.75%> $71,950 9% > $150,150 9.9% >$326,450	$5,000	$8,300	$3,200	$3,200	None
South Carolina (r)	No	2.5% > $0 3% > $2,530 4% > $5,060 5% > $7,590 6% > $10,120 7% > $12,650	$5,000 (s)	$10,000 (s)	$3,200 (s)	$3,200 (s)	None
South Dakota	No	None	n.a.	n.a.	n.a.	n.a.	None
Tennessee	No	6% > $0 (h)	n.a.	n.a.	$1,250	n.a.	None
Texas	No	None	n.a.	n.a.	n.a.	n.a.	None
Utah	Yes	2.3% > $0 3.3% > $863 4.2% > $1,726 5.2% > $2,588 6% > $3,450 7% > $4,313	$5,000 (s)	$10,000 (s)	$2,400 (q)	$2,400 (q)	None
Vermont (r)	No	3.6% > $0 7.2% > $29,700 8.5% > $71,950 9% > $150,150 9.5% > $326,450	$5,000 (s)	$10,000 (s)	$3,200 (s)	$3,200 (s)	None
Virginia	No	2% > $0 3% > $3,000 5% > $5,000 5.75% > $17,000	$3,000	$6,000	$900	$900	None

Table 12 (Continued)
Individual Income Tax Rates, as of July 1, 2006

State	Federal Deductibility	Tax Rates and Brackets for Single Filers (a)	Standard Deduction		Personal Exemptions (b)		Local Option Income tax Rate (v)
			Single	Joint	Single	Dependents	
Washington	No	None	n.a.	n.a.	n.a.	n.a.	None
West Virginia	No	3% > $0 4% > $10,000 4.5% > $25,000 6% > $40,000 6.5% > $60,000	n.a.	n.a.	$2,000	$2,000	None
Wisconsin (r)	No	4.60% > $0 6.15% > $8,840 6.50% > $17,680 6.75% > $132,581	$8,140 (j)	$14,710 (j)	$700	$700	None
Wyoming	No	None	n.a.	n.a.	n.a.	n.a.	None
District of Columbia	No	4.5% > $0 7% > $10,000 8.7% > $40,000	$2,000	$2,000	$1,370	$1,370	n.a.

(a) Applies to single taxpayers and married people filing separately. Most states double brackets for married filing joint.

(b) Married-joint filers generally receive double the single exemption.

(c) Tax credit.

(d) Rates listed assume that taxpayers opt not to deduct their federal income tax liability. In Oklahoma, if a filer chooses to deduct his federal liability, then he faces a range of rates from 0.5%-10% on income up to $1,000 and over $16,000 respectively.

(e) Maximum equals $12,625. Value decreases as income increases.

(f) The 12% rate applies to short-term capital gains, long- and short-term capital gains on collectibles and pre-1996 installment sales classified as capital gain income for Massachusetts purposes.

(g) Taxpayers receive a $20 tax credit per exemption in addition to the normal exemption amount.

(h) Applies to interest and dividend income only.

(I) Additional $1,500 dependent child exemption.

(j) Deduction phases out to zero for single filers at $80,000 and joint filers at $90,895.

(k) Rates apply to regular tax table. A special tax table is available for low-income taxpayers that reduce their tax payments.

(l) Standard deduction and personal exemptions are combined: $4,500 for single and married filing separately; $9,000 married filing jointly and head of household.

(m) The standard deduction is 15 percent of income with a minimum of $1,500 and a cap of $2,000 for single filers, married filing separately filers and dependent filers earning more than $13,333. The standard deduction is capped at $4,000 for married filing jointly filers, head of household filers and qualifying widowers earning more than $26,667.

(n) The $103 personal exemption credit is phased out for filers with adjusted gross income of $73,000 or more.

(o) Exemptions are based on federal standard deductions but are adjusted according to income and filing status.

(p) The deduction given is applicable to all filers, excluding married filing separately filers, with adjusted gross income (AGI) over $13,333. For those with AGI between $6,666 and $13,333 the standard deduction is 15% of AGI and for those with AGI of less than $6,666 the standard deduction is $1,000. For married filing separately filers, the standard deduction is $500 or 15% of AGI, but not to exceed $1,000.

(q) Three-fourths federal exemption.

(r) Indexes for Inflation.

(s) Deductions and exemptions tied to Federal tax system. Federal deductions and exemptions are indexed for inflation.

(t) Residents should deduct the federal income tax liability as shown on their 2005 federal income tax return.

(u) Usually limited to $5,000, but the limit is $10,000 if you checked Box C on Line 9.

(v) Weighted average of rates in counties and large municipalities.

Sources: Tax Foundation, state tax forms and instructions and Commerce Clearing House.

Table 13
Individual Income Tax Base Criteria, as of July 1, 2006

State	Marriage Penalty	Allow Filing Separtely on a Single Return	Double Taxation			Indexation		
			Interest	Dividends	Capital Gains	Brackets	Standard Deduction	Exemption
Alabama	No	No	Yes	Yes	Yes	No	No	No
Alaska	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Arizona	No	No	Yes	Yes	Yes	No	No	No
Arkansas	Yes	Yes	Yes	Yes	Yes	Yes	No	No
California	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Colorado	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Connecticut	No	No	Yes	Yes	Yes	No	No	No
Delaware	Yes	Yes	Yes	Yes	Yes	No	No	No
Florida	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Georgia	Yes	No	Yes	Yes	Yes	No	No	No
Hawaii	Yes	No	Yes	Yes	Yes	No	No	No
Idaho	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Illinois	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Indiana	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Iowa	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Kansas	No	No	Yes	Yes	Yes	No	No	No
Kentucky	Yes	Yes	Yes	Yes	Yes	No	Yes	No
Louisiana	No	No	Yes	Yes	Yes	No	No	No
Maine	Yes	No	Yes	Yes	Yes	Yes	Yes	No
Maryland	Yes	No	Yes	Yes	Yes	No	No	No
Massachusetts	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Michigan	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Minnesota	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Mississippi	Yes	Yes	Yes	Yes	Yes	No	No	No
Missouri	Yes	Yes	Yes	Yes	Yes	No	Yes	No
Montana	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Nebraska	Yes	No	Yes	Yes	Yes	No	No	Yes
Nevada	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
New Hampshire	No	No	Yes	Yes	No	Yes	Yes	Yes
New Jersey	Yes	No	Yes	Yes	Yes	No	No	No
New Mexico	Yes	No	Yes	Yes	Yes	No	Yes	Yes
New York	No	No	Yes	Yes	Yes	No	No	No
North Carolina	Yes	No	Yes	Yes	Yes	No	No	No
North Dakota	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Ohio	Yes	No	Yes	Yes	Yes	No	No	Yes
Oklahoma	Yes	No	Yes	Yes	Yes	No	No	No
Oregon	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Pennsylvania	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Rhode Island	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
South Carolina	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
South Dakota	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tennessee	No	No	Yes	Yes	No	Yes	Yes	Yes
Texas	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Utah	No	No	Yes	Yes	Yes	No	Yes	Yes
Vermont	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Virginia	Yes	Yes	Yes	Yes	Yes	No	No	No
Washington	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
West Virginia	Yes	No	Yes	Yes	Yes	No	No	No
Wisconsin	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Wyoming	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
District of Columbia	Yes	Yes	Yes	Yes	Yes	No	No	No

Sources: Commerce Clearing House, Congressional Budget Office, Tax Foundation.

Table 14
Other Individual Income Tax Base Criteria, as of July 1, 2006

State	Federal Income Used As State Tax Base	State Tax Deductible	Foreign Tax Deductible	AMT Levied	Recognition LLC Status	Recognition of S-Corp Status
Alabama	No	Yes	Yes	No	Yes	Yes
Alaska	n.a.	n.a.	n.a.	n.a.	No	Yes
Arizona	Yes	Yes	Yes	No	Yes	Yes
Arkansas	No	Yes	Yes	No	Partial	Yes
California	Yes	Yes	Yes	Yes	Yes	Partial
Colorado	Yes	Yes	Yes	Yes	Yes	Yes
Connecticut	Yes	Yes	Yes	Yes	Yes	Yes
Delaware	Yes	Yes	Yes	No	Yes	Yes
Florida	n.a.	n.a.	n.a.	n.a.	Yes	Yes
Georgia	Yes	Yes	Yes	No	Yes	Yes
Hawaii	Yes	Yes	Yes	No	Yes	Yes
Idaho	Yes	Yes	Yes	No	Yes	Yes
Illinois	Yes	No	No	No	Yes	Partial
Indiana	Yes	Yes	Yes	No	Yes	Yes
Iowa	No	Yes	Yes	Yes	Yes	Yes
Kansas	Yes	Yes	Yes	No	Yes	Yes
Kentucky	Yes	Yes	Yes	No	No	No
Louisiana	Yes	Yes	Yes	No	Yes	No
Maine	Yes	Yes	Yes	Yes	Yes	Yes
Maryland	Yes	Yes	Yes	Yes	Yes	Yes
Massachusetts	Yes	Yes	Yes	No	Yes	Yes
Michigan	Yes	Yes	Yes	No	Yes	No
Minnesota	Yes	Yes	Yes	Yes	Yes	Yes
Mississippi	No	Yes	Yes	No	Yes	Yes
Missouri	Yes	Yes	Yes	No	Yes	Yes
Montana	Yes	Yes	Yes	No	Yes	Yes
Nebraska	Yes	Yes	Yes	Yes	Yes	Yes
Nevada	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
New Hampshire	No	Yes	Yes	No	Partial	No
New Jersey	No	Yes	Yes	No	Partial	Yes
New Mexico	Yes	Yes	Yes	No	Yes	Yes
New York	Yes	Yes	Yes	Yes	Yes	Partial
North Carolina	Yes	Yes	Yes	No	Yes	Yes
North Dakota	Yes	Yes	Yes	No	Yes	Yes
Ohio	Yes	Yes	Yes	No	Partial	Yes
Oklahoma	Yes	Yes	Yes	No	Yes	Yes
Oregon	Yes	Yes	Yes	No	Yes	Yes
Pennsylvania	No	Yes	Yes	No	Yes	Yes
Rhode Island	Yes	Yes	Yes	Yes	Yes	Partial
South Carolina	Yes	Yes	Yes	No	Yes	Yes
South Dakota	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tennessee	No	Yes	Yes	No	Yes	No
Texas	n.a.	n.a.	n.a.	n.a.	No	No
Utah	Yes	Yes	Yes	No	Yes	Yes
Vermont	Yes	Yes	Yes	No	Yes	Yes
Virginia	Yes	Yes	Yes	No	Partial	Yes
Washington	n.a.	n.a.	n.a.	n.a.	Yes	Yes
West Virginia	Yes	Yes	Yes	Yes	Yes	Yes
Wisconsin	Yes	Yes	Yes	Yes	Yes	Yes
Wyoming	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
District of Columbia	Yes	Yes	Yes	No	Yes	No

Source: Commerce Clearing House.

Table 15
State Sales and Excise Tax Rates, as of July 1, 2006

State	State Sales and Use Tax Rate	Weighted Average of County and City Rates	State Allows Localitites to Define Sales Tax Base	Gasoline Excise Tax (cents per gallon)	Diesel Excise Tax (cents per gallon)	Tobacco Excise Tax (cents per pack)	Beer Excise Tax (cents per gallon)	Distilled Spirits Tax (dollars per gallon)
Alabama	4.0%	2.67%	No	18.0¢	19.0¢	42.5¢	53¢	$14.78 (b)
Alaska	None	3.14%	No	8.0¢	8.0¢	180.0¢	107¢	$12.80
Arizona	5.6%	2.15%	No	18.0¢	18.0¢	118.0¢	16¢	$3.00
Arkansas	6.0%	1.51%	No	21.5¢	22.5¢	59.0¢	24¢	$2.58
California	6.25%	1.50%	No	18.0¢	18.0¢	87.0¢	20¢	$3.30
Colorado	2.9%	1.61%	Yes	22.0¢	20.5¢	84.0¢	8¢	$2.28
Connecticut	6.0%	None	No	25.0¢	26.0¢	151.0¢	19¢	$4.50
Delaware	None	None	No	23.0¢	22.0¢	55.0¢	16¢	$3.75
Florida	6.0%	0.45%	No	14.9¢	27.7¢	33.9¢	48¢	$6.50
Georgia	4.0%	1.10%	No	15.3¢	16.5¢	37.0¢	48¢	$3.79
Hawaii	4.0%	None	No	16.0¢	16.0¢	140.0¢	93¢	$5.98
Idaho	6.0%	None	Yes	25.0¢	25.0¢	57.0¢	15¢	$8.86 (b)
Illinois	6.25%	1.30%	No	19.0¢	22.6¢	98.0¢	19¢	$4.50
Indiana	6.0%	None	No	18.0¢	16.0¢	55.5¢	12¢	$2.68
Iowa	5.0%	1.07%	No	20.7¢	22.5¢	36.0¢	19¢	$10.79
Kansas	5.3%	1.52%	No	24.0¢	26.0¢	79.0¢	18¢	$2.50
Kentucky	6.0%	None	No	18.5¢	15.5¢	30.0¢	8¢	$1.94
Louisiana	4.0%	4.32%	No	20.0¢	20.0¢	36.0¢	32¢	$2.50
Maine	5.0%	None	No	25.9¢	27.0¢	200.0¢	35¢	$4.06 (b)
Maryland	5.0%	None	No	23.5¢	24.3¢	100.0¢	9¢	$1.50
Massachusetts	5.0%	None	No	21.0¢	21.0¢	151.0¢	11¢	$4.05
Michigan	6.0%	None	No	19.0¢	15.0¢	200.0¢	20¢	$10.03 (b)
Minnesota	6.5%	0.23%	No	20.0¢	20.0¢	123.0¢	15¢	$5.08
Mississippi	7.0%	None	No	18.0¢	18.4¢	18.0¢	43¢	$6.34 (b)
Missouri	4.225%	1.80%	No	17.0¢	17.6¢	17.0¢	6¢	$2.00
Montana	None	None	No	27.0¢	27.8¢	170.0¢	14¢	$7.26 (b)
Nebraska	5.5%	0.85%	No	26.1¢	27.0¢	64.0¢	29¢	$3.75
Nevada	6.5%	2.93%	No	24.8¢	27.8¢	80.0¢	16¢	$3.60
New Hampshire	None	None	No	19.6¢	19.6¢	80.0¢	30¢	(b)
New Jersey	6.0% (a)	None	No	14.5¢	17.5¢	240.0¢	12¢	$4.40
New Mexico	5.0%	1.39%	No	18.9¢	22.9¢	91.0¢	41¢	$6.06
New York	4.0%	4.24%	Yes	36.9¢	22.2¢	150.0¢	11¢	$6.44
North Carolina	4.5%	2.56%	No	30.2¢	30.2¢	30.0¢	53¢	$8.98 (b)
North Dakota	5.0%	0.65%	No	23.0¢	23.0¢	44.0¢	16¢	$2.50
Ohio	5.5%	1.25%	No	28.0¢	28.0¢	125.0¢	18¢	$8.40 (b)
Oklahoma	4.5%	2.38%	No	17.0¢	14.0¢	103.0¢	40¢	$5.56
Oregon	None	None	No	24.0¢	24.0¢	118.0¢	8¢	$17.77 (b)
Pennsylvania	6.0%	0.12%	No	31.2¢	38.1¢	135.0¢	8¢	$6.48 (b)
Rhode Island	7.0%	None	No	31.0¢	31.0¢	246.0¢	10¢	$3.75
South Carolina	0.48%	0.51%	No	16.0¢	16.0¢	7.0¢	77¢	$4.97
South Dakota	0.80%	None	No	22.0¢	22.0¢	53.0¢	27¢	$3.93
Tennessee	7.0%	3.41%	No	21.4¢	18.4¢	20.0¢	14¢	$4.46
Texas	6.25%	0.85%	No	20.0¢	20.0¢	41.0¢	20¢	$2.40
Utah	4.75%	1.56%	No	24.5¢	24.5¢	69.5¢	41¢	$9.19 (b)
Vermont	6.0%	None	No	20.0¢	26.0¢	179.0¢	27¢	$0.10 (b)
Virginia	4.0%	1.00%	No	17.5¢	16.0¢	30.0¢	26¢	$14.02 (b)
Washington	6.5%	1.99%	No	31.0¢	31.0¢	202.5¢	26¢	$21.15 (b)
West Virginia	6.0%	None	No	27.0¢	27.0¢	55.0¢	18¢	$1.70 (b)
Wisconsin	5.0%	0.38%	No	33.9¢	32.9¢	77.0¢	6¢	$3.25
Wyoming	4.0%	1.30%	No	14.0¢	14.0¢	60.0¢	2¢	(b)
District of Columbia	5.75%	n.a.	No	22.5¢	22.5¢	100.0¢	26¢	$1.50

(a) 7 cents as of July 15, 2006.
(b) Sixteen states outlaw private liquor sales and set up state-run stores. These are called "control states" while "license states" are those that permit private wholesale and retail sales. All license states have an excise tax rate in law, expressed in dollars per gallon. Control states levy no statutory tax but usually raise comparable revenue by charging higher prices. In July 2005, the Distilled Spirits Council of the U.S., a trade association, computed approximate excise tax rates for control states by comparing prices of typical products sold in their state-run stores to the pre-tax prices of liquor in states where liquor is privately sold. In New Hampshire and Wyoming, average liquor prices charged in state-run stores are lower than pre-tax prices in license states.

Sources: Commerce Clearing House, American Petroleum Institute, Orzechowski & Walker, Beer Institute, Distilled Spirits Council of the U.S., and Tax Foundation.

Table 16
State Sales Tax Exemptions for Business-to-Business Transactions: Agriculture, Manufacturing and Machinery Inputs, as of July 1, 2006

	Insecticides and Pesticides	Fertilizer, Seed and Feed	Seedlings, Plants and Shoots	Manufacturing Machinery	Utilities	Farm Machinery	Raw Material	Office Equipment	Pollution Control Equipment	
									Air	Water
Alabama	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Exempt	Taxable	Exempt	Exempt
Alaska	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Arizona	Taxable	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt
Arkansas	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt
California	Taxable	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable
Colorado	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Connecticut	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Delaware	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Florida	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Exempt	Taxable	Exempt	Exempt
Georgia	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt
Hawaii	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Exempt	Taxable
Idaho	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Illinois	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Taxable	Taxable
Indiana	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Iowa	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Kansas	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Kentucky	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Louisiana	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Exempt	Exempt
Maine	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt
Maryland	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Massachusetts	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Michigan	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Minnesota	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Mississippi	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Exempt	Exempt
Missouri	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Montana	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Nebraska	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Nevada	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
New Hampshire	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
New Jersey	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Taxable	Taxable
New Mexico	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
New York	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
North Carolina	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
North Dakota	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
Ohio	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Oklahoma	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Oregon	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Pennsylvania	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Rhode Island	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
South Carolina	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
South Dakota	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
Tennessee	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Texas	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Utah	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Vermont	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Virginia	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Washington	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
West Virginia	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt
Wisconsin	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Taxable	Taxable
Wyoming	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable
District of Columbia	Taxable	Taxable	Taxable	Taxable	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable

Source: Commerce Clearing House.

Table 17
State Sales Tax Exemptions for Business-to-Business Transactions: Services, Software, Leasing and Rental Inputs, as of July 1, 2006

	General Treatment of Services	Cleaning Services	Transportation Services	Repair Services	Professional and Personal Services	Custom Software	Modified Canned Software	Downloaded Software	Motor Vehicles	Leasing Tangible Personal Property	Rooms & Lodgings
Alabama	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Exempt
Alaska	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Arizona	Many Taxable	Exempt	Taxable	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
Arkansas	Many Taxable	Taxable	Exempt	Taxable	Exempt	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
California	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt
Colorado	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
Connecticut	Many Taxable	Taxable	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
Delaware	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Florida	Many Taxable	Taxable	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Georgia	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable
Hawaii	Generally Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
Idaho	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
Illinois	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt	Exempt
Indiana	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable
Iowa	Many Taxable	Taxable	Exempt	Taxable	Taxable	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Kansas	Many Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable
Kentucky	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable
Louisiana	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable
Maine	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
Maryland	Exempt	Taxable	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Massachusetts	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt
Michigan	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
Minnesota	Many Taxable	Taxable	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
Mississippi	Generally Taxable	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
Missouri	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable
Montana	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Nebraska	Exempt	Taxable	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
Nevada	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt
New Hampshire	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
New Jersey	Exempt	Taxable	Exempt	Taxable	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
New Mexico	Generally Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
New York	Many Taxable	Taxable	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
North Carolina	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable
North Dakota	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable
Ohio	Many Taxable	Taxable	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable (a)	Taxable
Oklahoma	Many Taxable	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable
Oregon	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Pennsylvania	Many Taxable	Taxable	Exempt	Taxable	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Exempt
Rhode Island	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable
South Carolina	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable
South Dakota	Generally Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
Tennessee	Exempt	Exempt	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
Texas	Many Taxable	Taxable	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable	Exempt	Taxable	Exempt
Utah	Many Taxable	Exempt	Taxable	Taxable	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable
Vermont	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt
Virginia	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Taxable
Washington	Many Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
West Virginia	Generally Taxable	Taxable	Taxable	Taxable	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable
Wisconsin	Many Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable
Wyoming	Exempt	Exempt	Taxable	Taxable	Exempt	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable
District of Columbia	Many Taxable	Taxable	Exempt	Taxable	Exempt	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable

(a) Tax phases out completely in 2009. Current score reflects partial phase-out as of July 1, 2006.

Source: Commerce Clearing House.

Table 18
State Unemployment Insurance Tax Rates, 2006

State	Rates in Effect at the End of 2006			Most Favorable Schedule		Least Favorable Schedule	
	Minimum Rate	Maximum Rate	Taxable Wage Threshold	Minimum Rate	Maximum Rate	Minimum Rate	Maximum Rate
Alabama	0.44%	6.04%	$8,000	0.20%	5.40%	0.65%	6.80%
Alaska	1.21%	5.40%	$28,700	1.00%	5.40%	1.00%	5.40%
Arizona	0.02%	5.40%	$7,000	0.02%	5.40%	2.85%	5.40%
Arkansas	0.10%	10.00%	$10,000	None	9.90%	0.90%	10.80%
California	1.30%	5.40%	$7,000	0.10%	5.40%	1.30%	5.40%
Colorado	0.30%	5.40%	$10,000	None	5.40%	1.00%	5.40%
Connecticut	0.50%	5.40%	$15,000	0.50%	5.40%	1.50%	6.90%
Delaware	0.30%	8.20%	$8,500	0.10%	8.00%	0.10%	9.50%
Florida	0.32%	5.40%	$7,000	None	5.40%	0.00%	6.40%
Georgia	None	7.02%	$8,500	0.01%	5.40%	0.05%	10.80%
Hawaii	None	5.40%	$34,000	None	5.40%	2.40%	5.40%
Idaho	0.48%	5.40%	$29,200	0.10%	5.40%	2.40%	6.80%
Illinois	0.30%	8.10%	$11,000	0.20%	6.40%	0.20%	9.00%
Indiana	1.10%	5.60%	$7,000	0.15%	5.40%	1.10%	5.60%
Iowa	None	8.00%	$21,300	None	7.00%	None	9.00%
Kansas	0.07%	7.40%	$8,000	0.01%	7.40%	0.01%	7.40%
Kentucky	0.50%	9.50%	$8,000	0.30%	9.00%	1.00%	10.00%
Louisiana	0.10%	6.20%	$7,000	0.09%	6.00%	0.30%	6.00%
Maine	0.53%	5.40%	$12,000	0.50%	6.40%	2.40%	7.50%
Maryland	0.60%	9.00%	$8,500	0.30%	7.50%	2.20%	13.50%
Massachusetts	1.12%	10.96%	$14,000	0.80%	7.80%	1.58%	15.40%
Michigan	0.06%	10.30%	$9,000	None	8.00%	1.00%	10.00%
Minnesota	0.68%	11.00%	$24,000	0.10%	9.00%	0.60%	9.50%
Mississippi	0.40%	5.40%	$7,000	0.10%	5.40%	0.10%	5.40%
Missouri	None	6.00%	$11,000	None	5.40%	None	8.70%
Montana	0.13%	6.50%	$21,600	None	6.37%	1.67%	6.37%
Nebraska	0.39%	6.76%	$8,000	0.39%	5.40%	0.39%	5.40%
Nevada	0.25%	5.40%	$24,000	0.25%	5.40%	0.25%	5.40%
New Hampshire	0.01%	6.50%	$8,000	0.05%	6.50%	2.80%	6.50%
New Jersey	0.08%	5.40%	$25,800	0.30%	5.40%	1.20%	7.00%
New Mexico	0.03%	5.40%	$17,900	0.03%	5.40%	2.70%	5.40%
New York	0.90%	8.90%	$8,500	None	5.90%	0.90%	8.90%
North Carolina	None	5.70%	$17,300	None	5.40%	None	5.40%
North Dakota	0.49%	10.09%	$20,300	0.10%	10.09%	0.10%	10.09%
Ohio	0.50%	10.80%	$9,000	0.10%	6.30%	0.10%	6.70%
Oklahoma	0.20%	7.30%	$13,500	0.10%	5.50%	0.50%	5.50%
Oregon	1.20%	5.40%	$28,000	0.50%	5.40%	2.20%	5.40%
Pennsylvania	0.30%	6.39%	$8,000	0.30%	6.39%	1.02%	10.59%
Rhode Island	1.69%	9.79%	$16,000	0.60%	7.00%	1.90%	10.00%
South Carolina	1.24%	6.10%	$7,000	0.54%	5.40%	1.24%	6.10%
South Dakota	None	7.00%	$7,000	None	7.00%	1.50%	10.50%
Tennessee	0.30%	10.00%	$7,000	None	10.00%	0.50%	10.00%
Texas	0.40%	7.64%	$9,000	None	6.00%	None	6.00%
Utah	0.40%	9.40%	$24,000	0.10%	8.10%	0.10%	9.00%
Vermont	0.60%	5.90%	$8,000	0.40%	5.40%	1.30%	8.40%
Virginia	0.10%	6.20%	$8,000	None	5.40%	0.30%	6.40%
Washington	0.47%	6.12%	$30,900	0.47%	5.40%	2.47%	5.40%
West Virginia	1.50%	7.50%	$8,000	None	8.50%	1.50%	8.50%
Wisconsin	None	8.90%	$10,500	None	8.90%	0.27%	8.90%
Wyoming	0.29%	8.79%	$17,100	None	5.40%	None	8.50%
District of Columbia	1.30%	6.60%	$9,000	0.10%	5.40%	1.90%	7.40%

Source: U.S. Department of Labor

Table 19
State Unemployment Insurance Tax Base Criteria, as of July 1, 2006

State	State Experience Formula	Benefits Are Charged to Employers in Proportion to Base Period Wages	Company Charged for Benefits If					
			Employee's Benefit Award Reversed	Reimbursements on Combined Wage Claims	Employee Left Voluntarily	Employee Discharged for Misconduct	Employee Refused Suitable Work	Employee Continues to Work for Employer Part-time
Alabama	Benefit-Ratio	Yes	No	Yes	No	No	Yes	No
Alaska	Payroll Variation	No (a)	Yes	Yes	Yes	Yes	Yes	Yes
Arizona	Reserve-Ratio	Yes	No	No	No	No	Yes	No
Arkansas	Reserve-Ratio	Yes	Yes	Yes	No	No	Yes	No
California	Reserve-Ratio	Yes	No	Yes	No	No	Yes	No
Colorado	Reserve-Ratio	No (b)	No	No	No	No	Yes	Yes
Connecticut	Benefit-Ratio	Yes	Yes	Yes	No	No	No	Yes
Delaware	Benefit-Ratio	Yes	No	No	No	No	Yes	No
Florida	Benefit-Ratio	Yes	No	Yes	No	No	No	Yes
Georgia	Reserve-Ratio	No (a)	No	No	No	No	No	Yes
Hawaii	Reserve-Ratio	Yes	Yes	No	No	No	Yes	No
Idaho	Reserve-Ratio	No (a)	No	No	No	No	Yes	Yes
Illinois	Benefit-Ratio	No (a)	Yes	No	No	No	No	Yes
Indiana	Reserve-Ratio	Yes	Yes	No	No	No	Yes	No
Iowa	Benefit-Ratio	No (b)	No	No	No	No	No	Yes
Kansas	Reserve-Ratio	Yes	Yes	Yes	No	No	Yes	No
Kentucky	Reserve-Ratio	No (a)	Yes	No	No	No	Yes	Yes
Louisiana	Reserve-Ratio	Yes	No	Yes	No	No	No	No
Maine	Reserve-Ratio	No (a)	No	No	No	No	No	Yes
Maryland	Benefit-Ratio	Yes	No	Yes	No	Yes	Yes	No
Massachusetts	Reserve-Ratio	No (b)	No	Yes	No	No	Yes	Yes
Michigan	Benefit-Ratio	No (a)	Yes	Yes	No	No	No	No
Minnesota	Benefit-Ratio	Yes	Yes	No	No	No	Yes	Yes
Mississippi	Benefit-Ratio	Yes	Yes	Yes	No	No	No	No
Missouri	Reserve-Ratio	Yes	No	Yes	No	No	No	Yes
Montana	Reserve-Ratio	Yes	Yes	Yes	No	No	Yes	No
Nebraska	Reserve-Ratio	No (b)	No	Yes	No	No	Yes	Yes
Nevada	Reserve-Ratio	No (a)	Yes	No	No	No	Yes	Yes
New Hampshire	Reserve-Ratio	No (a)	Yes	No	Yes	Yes	Yes	Yes
New Jersey	Reserve-Ratio	Yes	No	Yes	No	No	No	Yes
New Mexico	Reserve-Ratio	Yes	No	Yes	No	No	Yes	Yes
New York	Reserve-Ratio	No (a)	Yes	Yes	No	No	Yes	No
North Carolina	Reserve-Ratio	Yes	No	Yes	No	No	Yes	No
North Dakota	Reserve-Ratio	Yes	No	Yes	No	No	Yes	Yes
Ohio	Reserve-Ratio	Yes	No	No	No	No	No	No
Oklahoma	Benefit-Ratio	Yes	No	Yes	No	No	Yes	No
Oregon	Benefit-Ratio	Yes	No	No	No	No	Yes	No
Pennsylvania	Benefit-Ratio	Yes	Yes	Yes	No	No	Yes	No
Rhode Island	Reserve-Ratio	No (a)	No	Yes	No	No	Yes	Yes
South Carolina	Reserve-Ratio	No (a)	No	Yes	No	No	No	Yes
South Dakota	Reserve-Ratio	No (b)	No	Yes	No	No	Yes	Yes
Tennessee	Reserve-Ratio	Yes	No	Yes	No	No	Yes	No
Texas	Benefit-Ratio	Yes	No	Yes	No	No	Yes	Yes
Utah	Benefit-Ratio	Yes	No	No	No	No	Yes	No
Vermont	Benefit-Ratio	Yes	Yes	No	No	No	No	No
Virginia	Benefit-Ratio	No (a)	Yes	No	No	No	No	Yes
Washington	Benefit-Ratio	No (b)	No	Yes	No	No	Yes	No
West Virginia	Reserve-Ratio	Yes	No	Yes	No	No	Yes	Yes
Wisconsin	Reserve-Ratio	Yes	No	Yes	No	Yes	Yes	Yes
Wyoming	Benefit-Ratio	Yes	No	Yes	No	No	Yes	No
District of Columbia	Reserve-Ratio	Yes	Yes	Yes	No	No	Yes	No

(a) Benefits charged to most recent employer.
(b) Benefits charged to base-period employers, most recent first.

Source: U.S. Department of Labor

Table 20
Other State Unemployment Insurance Tax Base Criteria, as of July 1, 2006

State	Solvency Tax	Taxes for Socialized Costs or Negative Balance Employer	Loan and Interest Repayment Surtaxes	Reserve Taxes	Surtaxes for UI Administration or Non-UI Purposes	Temporary Disability Insurance	Voluntary Contributions	Time-Period to to Qualify for Experience Rating (years)
Alabama	No	Yes	Yes	No	Yes	No	No	1
Alaska	Yes	No	No	No	Yes	No	No	1
Arizona	No	Yes	No	No	Yes	No	Yes	1
Arkansas	Yes	No	Yes	No	Yes	No	Yes	3
California	No	Yes	No	No	Yes	Yes	Yes	1
Colorado	Yes	Yes	Yes	No	Yes	No	Yes	1
Connecticut	Yes	No	Yes	No	No	No	No	1
Delaware	Yes	No	Yes	No	Yes	No	No	2
Florida	Yes	Yes	No	No	No	No	No	2.5
Georgia	No	No	No	No	Yes	No	Yes	3
Hawaii	No	No	No	No	Yes	Yes	No	1
Idaho	Yes	No	Yes	Yes	Yes	No	No	1
Illinois	Yes	No	No	No	No	No	No	3
Indiana	No	Yes	No	No	Yes	No	Yes	3
Iowa	No	No	Yes	No	Yes	No	No	3
Kansas	Yes	No	No	No	No	No	Yes	2
Kentucky	No	No	No	No	Yes	No	Yes	3
Louisiana	No	Yes	Yes	No	Yes	No	Yes	3
Maine	No	No	Yes	No	No	No	Yes	2
Maryland	Yes	No	No	No	No	No	No	2
Massachusetts	No	Yes	Yes	No	Yes	No	Yes	1
Michigan	No	Yes	No	No	No	No	Yes	2
Minnesota	Yes	Yes	Yes	No	Yes	No	Yes	1
Mississippi	No	Yes	No	No	No	No	No	1
Missouri	Yes	No	Yes	No	No	No	Yes	1
Montana	No	No	No	No	Yes	No	No	3
Nebraska	Yes	No	No	Yes	No	No	Yes	0
Nevada	No	No	No	No	Yes	No	No	2.5
New Hampshire	Yes	Yes	No	No	No	No	No	1
New Jersey	Yes	No	Yes	No	Yes	Yes	Yes	3
New Mexico	No	No	No	No	No	No	Yes	3
New York	Yes	No	Yes	No	Yes	Yes	Yes	1
North Carolina	No	No	No	Yes	No	No	Yes	2
North Dakota	Yes	No	No	No	No	No	Yes	3
Ohio	Yes	Yes	No	No	No	No	Yes	2
Oklahoma	No	No	No	No	No	No	No	1
Oregon	Yes	No	Yes	Yes	Yes	No	No	1
Pennsylvania	No	Yes	Yes	No	No	No	Yes	1.5
Rhode Island	No	Yes	No	No	Yes	Yes	No	3
South Carolina	No	No	No	No	Yes	No	No	2
South Dakota	No	Yes	No	No	Yes	No	Yes	2
Tennessee	No	No	Yes	No	Yes	No	No	3
Texas	No	Yes	Yes	No	Yes	No	Yes	1
Utah	No	Yes	No	No	No	No	No	1
Vermont	No	No	No	No	No	No	No	1
Virginia	Yes	Yes	No	No	No	No	No	1
Washington	No	Yes	Yes	No	Yes	No	Yes	2
West Virginia	No	No	Yes	No	No	No	Yes	3
Wisconsin	No	Yes	Yes	No	Yes	No	Yes	1.5
Wyoming	No	Yes	No	No	Yes	No	No	3
District of Columbia	No	No	No	No	Yes	No	No	3

Source: U.S. Department of Labor

Table 21
Property Tax Rates and Capital Stock Taxes, as of July 1, 2006

	Property Tax		Capital Stock Tax		
	Property Tax Collections Per Capita	Property Tax Collections as a Percentage of Income	Capital Stock Tax Rate	Capital Stock Max Payment	Payment Options for CST and CIT
Alabama	$383	1.24%	0.175%	$15,000	Pay both
Alaska	$1,324	3.52%	None	n.a.	n.a.
Arizona	$862	2.72%	None	n.a.	n.a.
Arkansas	$399	1.40%	0.30%	$1,075,000	Pay both
California	$1,000	2.56%	None	n.a.	n.a.
Colorado	$1,061	2.65%	None	n.a.	n.a.
Connecticut	$2,007	3.98%	0.31%	$1,000,000	Pay highest
Delaware	$558	1.43%	0.90%	$165,000	Pay both
Florida	$1,087	3.10%	None	n.a.	n.a.
Georgia	$905	2.75%	0.023%	$5,000	Pay both
Hawaii	$572	1.57%	None	n.a.	n.a.
Idaho	$794	2.68%	None	n.a.	n.a.
Illinois	$1,453	3.82%	0.10%	$2,000,000	Pay both
Indiana	$1,004	3.04%	None	n.a.	n.a.
Iowa	$1,106	3.25%	None	n.a.	n.a.
Kansas	$1,229	3.57%	0.20%	$20,000	Pay both
Kentucky	$537	1.79%	None	n.a.	n.a.
Louisiana	$524	1.76%	0.30%	Unlimited	Pay both
Maine	$1,653	4.99%	None	n.a.	n.a.
Maryland	$1,129	2.56%	None	n.a.	n.a.
Massachusetts	$1,596	3.43%	0.26%	Unlimited	Pay both
Michigan	$1,237	3.53%	None	n.a.	n.a.
Minnesota	$969	2.47%	None	n.a.	n.a.
Mississippi	$665	2.45%	0.25%	Unlimited	Pay both
Missouri	$773	2.29%	0.033%	Unlimited	Pay both
Montana	$1,051	3.40%	0.30%	Unlimited	Pay both
Nebraska	$1,168	3.32%	0.025	Unlimited	Pay both
Nevada	$954	2.50%	None	n.a.	n.a.
New Hampshire	$1,855	4.57%	None	n.a.	n.a.
New Jersey	$2,163	4.68%	None	n.a.	n.a.
New Mexico	$451	1.55%	None	n.a.	n.a.
New York	$1,726	4.07%	None	n.a.	n.a.
North Carolina	$738	2.29%	0.15%	$75,000	Pay both
North Dakota	$949	2.89%	None	n.a.	n.a.
Ohio	$1,015	2.96%	0.40%	Unlimited	Pay both
Oklahoma	$482	1.56%	0.125%	$20,000	Pay both
Oregon	$985	2.92%	None	n.a.	n.a.
Pennsylvania	$1,043	2.83%	0.489%	Unlimited	Pay both
Rhode Island	$1,695	4.44%	0.025%	Unlimited	Pay both
South Carolina	$915	3.05%	0.10%	Unlimited	Pay both
South Dakota	$933	2.84%	None	n.a.	n.a.
Tennessee	$631	1.92%	0.25%	Unlimited	Pay both
Texas	$1,301	3.80%	0.25%	Unlimited	Pay highest
Utah	$705	2.39%	None	n.a.	n.a.
Vermont	$2,043	5.83%	None	n.a.	n.a.
Virginia	$1,062	2.63%	None	n.a.	n.a.
Washington	$1,063	2.81%	None	n.a.	n.a.
West Virginia	$556	1.94%	0.70%	Unlimited	Pay both
Wisconsin	$1,385	3.93%	None	n.a.	n.a.
Wyoming	$1,470	3.82%	0.02%	Unlimited	Pay both
District of Columbia	$2,066	3.51%	None	n.a.	n.a.

Sources: Census Bureau, Commerce Clearing House, Tax Foundation.

Table 22
Other Property Tax Base Criteria, as of July 1, 2006

State	Intangible Property	Inventory	Real Estate Transfer	Estate Tax	Inheritance Tax	Generation Skip-Transfer	Gift Tax
Alabama	Yes	No	Yes	Copies Federal System	No	Yes	No
Alaska	No	Yes	No	Copies Federal System	No	No	No
Arizona	No	No	Yes	Copies Federal System	No	Yes	No
Arkansas	No	Yes	Yes	Copies Federal System	No	No	No
California	No	No	No	Copies Federal System	No	Yes	Yes
Colorado	No	No	Yes	Copies Federal System	No	Yes	No
Connecticut	No	No	Yes	Decoupled	No	Yes	Yes
Delaware	No	No	Yes	Copies Federal System	No	No	No
Florida	Yes	No	Yes	Copies Federal System	No	Yes	No
Georgia	No	Yes	Yes	Copies Federal System	No	No	No
Hawaii	No	No	Yes	Copies Federal System	No	Yes	No
Idaho	No	No	No	Copies Federal System	No	No	No
Illinois	No	No	No	Decoupled	No	Yes	No
Indiana	No	Yes	No	Copies Federal System	Yes	Yes	No
Iowa	No	No	Yes	Copies Federal System	Yes	Yes	No
Kansas	No	No	Yes	Copies Federal System	No	Yes	No
Kentucky	No	Yes	Yes	Copies Federal System	Yes	No	No
Louisiana	No	Yes	No	Copies Federal System	Yes	No	Yes
Maine	No	No	Yes	Decoupled	No	No	No
Maryland	No	Yes	Yes	Decoupled	Yes	Yes	No
Massachusetts	No	Partial	Yes	Decoupled	No	Yes	No
Michigan	No	No	Yes	Copies Federal System	Yes	Yes	No
Minnesota	No	No	Yes	Decoupled	No	No	No
Mississippi	Yes	Yes	No	Copies Federal System	No	No	No
Missouri	No	No	No	Copies Federal System	No	Yes	No
Montana	No	No	No	Copies Federal System	No	Yes	No
Nebraska	No	No	Yes	Decoupled	Yes	Yes	No
Nevada	No	No	Yes	Copies Federal System	No	Yes	No
New Hampshire	No	No	Yes	Copies Federal System	No	No	No
New Jersey	No	No	Yes	Decoupled	Yes	No	No
New Mexico	No	No	No	Copies Federal System	No	No	No
New York	No	No	Yes	Decoupled	No	Yes	No
North Carolina	No	No	Yes	Decoupled	No	Yes	Yes
North Dakota	No	No	No	Copies Federal System	No	No	No
Ohio	Yes	Yes (a)	Yes	Decoupled	No	Yes	No
Oklahoma	No	Yes	Yes	Decoupled	No	No	No
Oregon	No	No	No	Decoupled	No	No	No
Pennsylvania	Yes	No	Yes	Decoupled	Yes	No	No
Rhode Island	No	Yes	Yes	Decoupled	No	Yes	No
South Carolina	No	No	Yes	Copies Federal System	No	Yes	No
South Dakota	No	No	Yes	Copies Federal System	No	No	No
Tennessee	No	No	Yes	Copies Federal System	Yes	Yes	Yes
Texas	No	Yes	No	Copies Federal System	No	Yes	No
Utah	No	No	No	Copies Federal System	No	No	No
Vermont	No	Yes	Yes	Copies Federal System	No	Yes	No
Virginia	No	Yes	Yes	Decoupled	No	Yes	No
Washington	No	No	Yes	Decoupled	No	Yes	No
West Virginia	No	Yes	Yes	Copies Federal System	No	No	No
Wisconsin	No	No	Yes	Decoupled	No	No	No
Wyoming	No	No	No	Copies Federal System	No	No	No
District of Columbia	No	No	Yes	Decoupled	No	No	No

(a) Tax phases out completely in 2009. Current score reflects partial phase-out as of July 1, 2006.

Sources: Commerce Clearing House, Tax Foundation.

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States of Mind

A Quality Index for State Sales Tax Structure — Measuring the States Against an Ideal Standard[1]

by John L. Mikesell

Forty-five states levy retail sales taxes, but no two of these taxes has the same structure in terms of legal definitions, exemptions, exclusions, and so on. Because there is no comparable federal tax for states to build their taxes on, as states do with their individual income taxes, for instance, the variation in tax structures — and the tax policy they implement — is considerable across states. The Streamlined Sales Tax Project has worked strenuously to make compliance easier for vendors by establishing some standard definitions, administrative processes, and other features. However, the variation continues for the fundamental structures of the state sales taxes, and there has been no attempt to compare the several taxes against a standard sales tax structure that would embody desirable tax policy. This report provides an evaluation of the state sales tax structures against such a standard.

Some Sales Tax History

The retail sales tax in the United States emerged as an emergency state revenue source during the Great Depression of the 1930s. To patch over the collapse of property tax revenue, Mississippi, desperate for additional revenue, converted its business occupation levy into a 2 percent tax on retail sales in 1932. The tax produced revenue even in those difficult economic times and proved to be within the capacity of state administrators. Other states followed — 10 in 1933 and 29 by 1938. Table 1 (next page) shows how the tax spread among the states. Few states adopted the tax during World War II, but the pace picked up as states took on new financial obligations in the postwar period; real state spending was 44 percent higher in the immediate postwar years (1947 to 1950) than it had been in the immediate prewar years (1938 to 1941), and that increase would have been hard to accommodate without the yield contributed by this buoyant tax.[2] By 1969, only five states did not use the tax — and none has added it since then, despite periodic flurries of interest at varying degrees of seriousness in Oregon, Montana, New Hampshire, and Alaska. In only 15 years, the retail sales tax became the largest single tax source for state government, and it retained that rank from fiscal 1947 through fiscal 1997 and returned to that rank, at least temporarily, in fiscal 2003.

It would be reasonable to turn attention to the topic of making the sales tax bases themselves more consistent with the modern economy.

The tax played a significant role both in saving the states from financial collapse during the Depression and in supporting the significant expansion in the role of state government in the last half of the 20th century. However, the taxes were the product of the Depression economy and their structure has not changed dramatically since their earliest implementation. The model then was a conversion from business occupation taxes to retail sales taxes accomplished by raising taxes on retailing gross receipts from fractional rates to rates of 1 percent or more, facilitating shifting to customers, and excluding purchases of unfinished goods from the tax. Unfortunately, many sales taxes today continue the pattern of limited coverage of services and incomplete exclusion of purchases of business inputs that characterized the earliest taxes. It is immediately apparent that the economy for which the sales taxes were initially designed bears little resemblance to the economy of today. That is true in terms of technology, types of goods and services available, range of competition among vendors, business practices, and financing, to list only a few areas. Just as the streamlining project has devoted considerable attention to making sales tax compliance more appropriate for the economy of the 21st century, so too it would be reasonable to now turn attention to the equally important topic of making the sales tax bases themselves more consistent with the modern economy. In other words, it is now

[1] This report extends a presentation made at the 97th Annual Conference on Taxation of the National Tax Association, held in Minneapolis, November 11, 2004. It will be published in the conference proceedings.

[2] U.S. Bureau of Census, State Government Finances (Washington: U.S. Government Printing Office, various years).

Table 1
The Spread of State Retail Sales Taxes, 1932 to 2004

Taxes That Became Permanent		Taxes That Were Allowed to Expire		
Year	**State**	**State**	**Year of Expiration**	**Year of Reinstatement**
Prewar				
1932	Mississippi	Pennsylvania	1933	1953
1933	Arizona, California, Illinois, Michigan, North Carolina, Oklahoma, South Dakota, Utah, West Virginia	New York	1934	1965
1934	Iowa, Missouri, New Mexico	New Jersey	1935	1966
1935	Arkansas, Colorado, Hawaii,[a] North Dakota, Ohio, Washington, Wyoming	Kentucky	1936	1960
1937	Alabama, Kansas	Idaho	1936	1965
		Maryland	1936	1947
		Louisiana	1940	1942
Postwar				
1947	Connecticut, Rhode Island, Tennessee			
1949	Florida (and District of Columbia)			
1951	Georgia, Maine, South Carolina			
1953	Pennsylvania		1955	1956
1955	Nevada			
1961	Texas			
1962	Wisconsin			
1963	Indiana			
1966	Massachusetts, Virginia			
1967	Minnesota, Nebraska			
1969	Vermont			
	[a]Hawaii did not become a state until 1959.			

reasonable to turn to questions of fundamental tax policy and how the state sales taxes carry out that policy.

A Sales Tax Standard

What tax policy is a retail sales tax expected to be carrying out? Its essential logic is to distribute the cost of government according to household consumption expenditure. It is not an effective handle on any other fundamental base. It is not an income tax because it makes no allowance for costs associated with generating receipts from sales. It is not a punitive excise on use of resources in ways that are luxurious or harmful to ourselves or others. It is not a business activity tax with intent to distribute the cost of government according to business utilization of public services. It is the U.S. approach, albeit an imperfect one, to impose a general levy on consumption expenditure, collected on an indirect or transaction basis like the value added tax, but applied only at the last transaction in the chain of production and distribution leading to the household consumer. If the intent is to distribute governmental cost on a basis other than household consumption, some tax format other than the retail sales tax should be applied.

There are important incentive reasons associated with selecting a general consumption tax base. As a recent Economic Report of the President observes, a consumption tax "would not distort taxpayers' decisions about how much to save."[3] And policies that distort against saving can have a negative impact on rates of real capital formation and, accordingly, on the pace of improved standards of living in society. Beyond the incentive impact, there is also an important argument in terms of what fundamental basis should establish tax liability. Household consumption is driven by each individual household's own assessment of its capacity to afford goods and services provided by the private market. In a market economy, what more equitable standard would there be for dividing shares of the cost of government than exactly the shares of private goods and services that the household itself has decided that it can afford? The household consumption measure is a much more encompassing indicator of affluence than annual income because it is driven not only by income from the year but by accumulations from prior years and prospects for the future. Therefore, not only is a general consumption base supported by a desire for neutrality in economic choice but it is also supported by fundamental principles for measuring capacity to bear the cost of government services.

Given that the retail sales tax is the U.S. approach to general consumption taxation, what standard for evaluating structures of those taxes can be induced? John Due outlined the general standard almost 50 years ago. Although the economy has changed, those principles remain relevant. His standard holds that the sales tax structure should produce a uniform distribution

[3] Economic Report of the President 2003, p. 185.

(Text continued on p. 132.)

Table 2
Grading the State Sales Taxes: Summary Ratings

	Statutory Rate		Business Exemption		Household Inclusion		Agricultural Inputs		Services		Nonprofit Organizations		Type of Tax		Total
	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	
NEW ENGLAND															
Connecticut	6	36.2	5.5	47.1	1	25.7	3	56.1	3	57.8	5	53.0	10	63.3	380.3
Maine	8.5	53.6	5.5	47.1	4	51.8	3	56.1	0	41.6	5	53.0	5	51.1	427.6
Massachusetts	10	64.1	7	55.6	2	34.4	3	56.1	0	41.6	5	53.0	5	51.1	420.4
Rhode Island	6	36.2	6	49.9	2	34.4	3	56.1	0	41.6	5	53.0	0	38.9	375.0
Vermont	6	36.2	7	55.6	1.5	30.1	3	56.1	0	41.6	2	45.7	0	38.9	370.3
Average															394.7
MIDEAST															
Maryland	10	64.1	8	61.3	2.5	38.8	3	56.1	0	41.6	5	53.0	0	38.9	434.4
New Jersey	7.5	46.6	5	44.3	2	34.4	3	56.1	0	41.6	2	45.7	5	51.1	372.9
New York	10	64.1	7	55.6	3	43.1	3	56.1	3	57.8	2	45.7	0	38.9	440.6
Pennsylvania	7.5	46.6	8	61.3	2	34.4	3	56.1	3	57.8	5	53.0	0	38.9	424.4
Average															418.1
GREAT LAKES															
Illinois	6	36.2	8.5	64.1	5	60.5	3	56.1	0	41.6	5	53.0	5	51.1	461.6
Indiana	6	36.2	5.75	48.5	4.5	56.2	3	56.1	0	41.6	5	53.0	5	51.1	421.7
Michigan	6	36.2	6	49.9	4.5	56.2	3	56.1	0	41.6	5	53.0	10	63.3	430.6
Ohio	7.5	46.6	9	67.0	3	43.1	3	56.1	3	57.8	5	53.0	0	38.9	453.2
Wisconsin	10	64.1	6	49.9	4	51.8	3	56.1	3	57.8	5	53.0	10	63.3	466.1
Average															446.7
PLAINS															
Iowa	10	64.1	6	49.9	3	43.1	3	56.1	3	57.8	0	40.8	0	38.9	424.3
Kansas	10	64.1	5	44.3	4.5	56.2	3	56.1	3	57.8	5	53.0	5	51.1	457.4
Minnesota	6	36.2	5.5	47.1	2	34.4	3	56.1	3	57.8	5	53.0	5	51.1	391.6
Missouri	8.5	53.6	6.5	52.8	3.5	47.5	3	56.1	0	41.6	2	45.7	0	38.9	416.9
Nebraska	7.5	46.6	4	38.6	4	51.8	2.5	47.1	0	41.6	5	53.0	0	38.9	388.6
North Dakota	8.5	53.6	5	44.3	4	51.8	2	38.2	0	41.6	2	45.7	10	63.3	402.9
South Dakota	8.5	53.6	2	27.2	5	60.5	2	38.2	5	68.6	5	53.0	10	63.3	420.5
Average															414.6
SOUTHEAST															
Alabama	8.5	53.6	8.5	64.1	5	60.5	2.5	47.1	0	41.6	3	48.1	5	51.1	465.3
Arkansas	8.5	53.6	3.75	37.2	5	60.5	3	56.1	3	57.8	0	40.8	5	51.1	429.2
Florida	6	36.2	6.5	52.8	3.5	47.5	2	38.2	3	57.8	5	53.0	5	51.1	411.2
Georgia	10	64.1	5	44.3	3.5	47.5	3	56.1	0	41.6	3	48.1	5	51.1	418.9
Kentucky	7.5	46.6	5.5	47.1	4	51.8	3	56.1	0	41.6	5	53.0	10	63.3	426.7
Louisiana	8.5	53.6	3.5	35.7	5	60.5	2	38.2	0	41.6	3	48.1	0	38.9	393.5
Mississippi	6	36.2	3	32.9	5	60.5	2	38.2	5	68.6	3	48.1	0	38.9	397.3
North Carolina	8.5	53.6	4	38.6	3.5	47.5	2	38.2	0	41.6	5	53.0	0	38.9	377.9
South Carolina	8.5	53.6	6	49.9	4	51.8	3	56.1	0	41.6	0	40.8	10	63.3	427.2
Tennessee	7.5	46.6	4.5	41.4	4.5	56.2	3	56.1	0	41.6	5	53.0	10	63.3	424.1
Virginia	8.5	53.6	10	72.7	3.5	47.5	3	56.1	0	41.6	5	53.0	5	51.1	470.1
West Virginia	6	36.2	8	61.3	5	60.5	3	56.1	5	68.6	5	53.0	0	38.9	476.9
Average															426.5

(Table 2 continued next page.)

(Table 2 continued)

	Statutory Rate		Business Exemption		Household Inclusion		Agricultural Inputs		Services		Nonprofit Organizations		Type of Tax		Total
	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	(raw)	(t)	
SOUTHWEST															
Arizona	7.5	46.6	6	49.9	4	51.8	1.5	29.3	3	57.8	0	40.8	10	63.3	409.7
New Mexico	10	64.1	3	32.9	5	60.5	2.5	47.1	5	68.6	2	45.7	10	63.3	444.0
Oklahoma	10	64.1	6	49.9	5	60.5	3	56.1	3	57.8	5	53.0	5	51.1	477.4
Texas	7.5	46.6	6	49.9	2	34.4	3	56.1	3	57.8	5	53.0	5	51.1	407.8
Average															434.7
ROCKY MOUNTAIN															
Colorado	10	64.1	6	49.9	3.5	47.5	2.5	47.1	0	41.6	5	53.0	5	51.1	426.2
Idaho	7.5	46.6	8.75	65.6	5	60.5	3	56.1	0	41.6	5	53.0	0	38.9	468.9
Utah	8.5	53.6	7	55.6	5	60.5	3	56.1	3	57.8	5	53.0	0	38.9	472.2
Wyoming	8.5	53.6	4	38.6	5	60.5	3	56.1	0	41.6	5	53.0	0	38.9	421.9
Average															447.3
FAR WEST															
California	7.5	46.6	8	61.3	4.5	56.2	1	20.4	0	41.6	3	48.1	10	63.3	423.3
Hawaii	8.5	53.6	4.5	41.4	5	60.5	1	20.4	5	68.6	3	48.1	10	63.3	426.2
Nevada	7.5	46.6	6.5	52.8	4	51.8	2	38.2	0	41.6	2	45.7	10	63.3	412.9
Washington	6	36.2	8	61.3	4	51.8	2	38.2	3	57.8	3	48.1	0	38.9	426.0
Average															422.09

(Text continued from p. 130.)

in consumption, should be neutral regarding methods of production and distribution, and should be collected at a reasonable cost.[4] The guide for such an ideal retail sales tax is straightforward: the retail sales tax "should apply to all expenditures for personal consumption purposes but not to any transactions involving use in a business activity."[5] This guide, coupled with an effort to maintain uniformity, neutrality, and reasonable cost of collection, provides the standard against which the state sales tax structures would be gauged.

The States Against the Standard

There is no single index of state sales tax structure, so the measure to be proposed here will have to involve a series of value judgments, first about what characteristics are important for sales tax structure, second about how particular sales tax structures measure against those characteristics, and finally about how those characteristics are weighted in determining the final index or measure.[6] Following the standards outlined by Due, the sales tax structure should produce a uniform distribution on consumption, should be neutral regarding methods of production and distribution, and should be collected at reasonable cost.[7] While collected from vendors, the expectation (and basic rationale for the tax) is that the tax will be distributed according to household consumption. It is possible to have different evaluations at each stage, but an effort is made to provide a degree of process transparency so that those with differing standards can create their own measures. Those are the components of the evaluations that create the index scores reported in Table 2 (previous page).[8]

Statutory Rate

The sales tax should be levied at the lowest feasible statutory rate. That is important for competitive reasons, both internationally and domestically, and for general distortions of consumption and production. And there should be only a single rate so that administration is simpler, so there is not incentive for shifting economic activities between categories, and for uniformity of distribution. High and multiple rates create distortions and probably nonneutrality in production, distribution, and consumption. A high rating for the structural index is given to states with standard rates of 5.3 percent or less (the median

(Text continued on p. 134.)

[4] John F. Due, *Sales Taxation*. Urbana, Ill.: University of Illinois Press, 1957, pp. 41-42.

[5] John F. Due, "Sales Tax Exemptions — The Erosion of the Tax Base," Revenue Administration, 1982: Proceedings of the 50th Annual Meeting of the National Association of Tax Administrators 50 (1982), 200.

[6] Information about sales tax structures comes from Raymond J. Ring, "Consumers' Share and Producers' Share of the General Sales Tax," *National Tax Journal* 52 (March 1999), pp. 79-90; John L. Mikesell, "Sales Tax Incentives for Economic Development: Why Shouldn't Producers Exemptions Be General?" *National Tax Journal* 54 (September 2001): pp. 557-567; John L. Mikesell, "Sales Taxation of Nonprofit Organizations: Purchases and Sales," in William J. Fox, ed., *Sales Taxation: Critical Issues in Policy and Administration*, Westport, Conn.: Praeger, 1992; Research Institute of America, *2004 Guide to Sales and Use Taxation*, New York: Thomson RIA, 2004; and Commerce Clearing House, CCH Internet Tax Network [Online], and state tax departments.

[7] John F. Due, *Sales Taxation* (Urbana, Ill.: University of Illinois Press, 1957), pp. 41-42.

[8] This index is measured at a point in time and will, of course, change as states change their tax laws. For instance, since this measurement, the people of Oklahoma have approved a referendum to remove the sales tax from certain excised items and that would change the scoring for that state. Similar changes will regularly occur in legislative sessions, so the evaluations cannot be seen as permanent.

Table 3
Sales Tax Structure Evaluation Indices and Fiscal Performance

	Structure Index	Rank	Breadth %	Effort %	Reliance %
NEW ENGLAND					
Connecticut	380.3	41	34	2.04	32.2
Maine	427.6	16	45.6	2.28	31.8
Massachusetts	420.4	29	29	1.45	23.8
Rhode Island	375.0	43	34	2.23	31.9
Vermont	370.3	45	33.3	1.67	20.3
MIDEAST					
Maryland	434.4	13	33.6	1.68	31.5
New Jersey	372.9	44	28.3	1.7	29.8
New York	440.6	12	30.3	1.21	21
Pennsylvania	424.4	22	31.8	1.91	32.6
GREAT LAKES					
Illinois	461.6	8	24.8	1.55	29.9
Indiana	427.1	27	39.3	2.36	37.5
Michigan	430.6	14	41.6	2.49	33.6
Ohio	453.2	10	39.5	1.97	32.7
Wisconsin	466.1	6	44.3	2.21	30.7
PLAINS					
Iowa	424.3	23	40.4	2.02	34.1
Kansas	457.4	9	43.7	2.32	37.7
Minnesota	391.6	39	43.3	2.81	36.6
Missouri	416.9	31	40.0	1.69	32.7
Nebraska	388.6	40	48.3	2.66	42.4
North Dakota	402.9	36	46.5	2.32	36.5
South Dakota	420.5	28	54.1	2.16	47.9
SOUTHEAST					
Alabama	465.3	7	40	1.6	29.5
Arkansas	429.2	15	57.5	2.95	37.9
Florida	411.2	33	48.5	2.91	56.0
Georgia	418.9	30	46.3	1.85	35.3
Kentucky	426.7	18	43.5	2.61	33.9
Louisiana	393.5	38	59.2	2.37	37.3
Mississippi	397.3	37	52.1	3.65	49.8
North Carolina	377.9	42	37.4	1.68	25.2
South Carolina	427.2	17	47.5	2.38	40.6
Tennessee	424.1	24	46.5	3.26	61.4
Virginia	470.1	4	25.5	1.33	38.0
West Virginia	476.9	2	43.0	2.58	31.7
SOUTHWEST					
Arizona	409.7	34	51.1	2.86	49.3
New Mexico	444.0	11	62.3	3.11	41.3
Oklahoma	477.4	1	35.7	1.61	25.5
Texas	407.8	35	42.9	2.68	59.8

(Table 3 continued next page.)

(Table 3 continued)					
	Structure Index	**Rank**	**Breadth %**	**Effort %**	**Reliance %**
ROCKY MOUNTAIN					
Colorado	426.2	20	40.5	1.18	27.6
Idaho	468.9	5	47.6	2.38	35.9
Utah	472.2	3	53.3	2.53	37.6
Wyoming	421.9	26	53.3	2.59	34.9
FAR WEST					
California	423.3	25	34.7	2.08	31.4
Hawaii	426.2	19	34.7	4.39	47.8
Nevada	412.9	32	9.8	3.13	53.1
Washington	426.0	21	48.1	2.94	46.3
Source: John L. Mikesell, "State Retail Sales Tax Burdens, Reliance, and Breadth in Fiscal 2003," *State Tax Notes*, July 12, 2004, p. 125, *2004 STT 133-4*, or *Doc 2004-12458*.					

(Text continued from p. 132.)

rate in July 2004); higher standard rates constrain the revenue-raising buoyancy of the tax for the future and reduce the jurisdiction's competitive stance. The rating is reduced if the sales tax has multiple rates. The scoring standard is as follows: If the state standard rate is 5.3 percent or below and a single rate applies, 10 points; if the state standard rate is 5.3 percent or below and there are multiple rates, 8.5 points; if the state standard rate is above 5.3 and a single rate applies, 7.5 points; and if the state standard rate is above 5.3 and there are multiple rates, 6 points.

Business Purchase Exclusion

The sales tax should exclude business purchases from the base. If they are not excluded, the true burden of the tax is not transparent to the public and the economy is less attractive to economic development in comparison with both international and domestic competitors. Purchase categories considered were purchases of inventory, ingredients, materials used for research, electricity, gas, water, fuel, custom software, equipment and machinery, and pollution-control equipment. If the category was fully exempt, the state received one point; if the category was fully taxed, the state received zero points; intermediate points were given if the category was partially exempt, exempt under certain conditions (for example, purchased by a new or expanding firm), or taxed at a reduced rate. The scoring standard for the state structures follows: The tax receives one point each for resale exemption, materials — ingredients exemption, materials — research exemption, electricity exemption, gas exemption, water exemption, fuel exemption, custom software exemption, production equipment and machinery exemption, and pollution-control equipment exemption. It receives zero points if the purchase category is not exempt and 0.5 points for partial exemption (for example, new and expanded industry only). The test should not be whether the purchase is of something "finished," but whether the purchase is by a household consumer.

Household Purchase Inclusion

The sales tax should include all consumption expenditures in the base. That is important for equity, for efficiency, and as a mechanism for allowing the statutory tax rate to be as low as possible, consistent with intended sales tax reliance. The ratings are based on whether the tax fully taxes grocery food, clothing, nonprescription medicine, motor fuels, and cigarettes and alcoholic beverages. Reduced rates and partial coverage (for example, excluding any selective excise) were given partial credit. The state scoring follows: 1 point for food taxed, clothing taxed, nonprescription medicine taxed, no permanent tax holiday, motor fuel fully taxed, and cigarettes and alcoholic beverages fully taxed. Half a point was given to states with a tax holiday in 2004, but legislated annually, and for excised goods taxed but on a net-of-excise basis.

Purchases of Agricultural Inputs

Purchases of insecticides, pesticides, fertilizer, seeds, machinery, and equipment by agricultural producers are business input purchases and should be exempt. Ratings were based on whether those purchases are exempt from sales tax. The state scoring: 1 point for exemption of insecticides, fertilizer and seed, and machinery and equipment purchased for agricultural production.

Services

The sales tax should include household purchases of services and intangible personal property on exactly the same standard as applies to purchases of goods. Unless services are included, the tax would suffer from fundamental inequity and a growing share of the potential base would be outside the coverage of the tax. Ratings were based on whether services were generally or almost generally taxed, whether coverage was extensive but not general, or whether services were excluded from the tax. The state scoring: 5 points for general or

near-general coverage of services, 3 points for extensive selective coverage, and zero points for no coverage.

Nonprofit Organizations

Nonprofit organizations are producers of goods and services and may be sellers of what they produce. According to the basic logic of the sales tax, their purchases should be exempt and their sales should be taxed. The highest rating is given to states that exempt their purchases and tax their sales; the lowest rating is given to states that tax their purchases and exempt their sales; other combinations receive intermediate ratings. The state scoring: 5 points if purchases are exempt and sales are taxed, 3 points if purchases and sales are both taxed, 2 points if purchases and sales are both exempt, and zero points if purchases are taxed and sales are exempt.

Tax Type

Sales taxes may be classified as vendor privilege taxes, consumer taxes on the sale, or taxes that are hybrids of the two. There are advantages to placing clear legal liability on the vendor in terms of responsibility for payment, some reduction in the tendency to exempt by class of purchaser, standing in the event of vendor bankruptcy, and greater flexibility in providing exemption by use of purchase. The highest rating is given to states with vendor basis, the lowest rating to states with consumer basis, and an intermediate rating to states with hybrid systems. The scoring: 10 points for vendor type, 5 points for hybrid, and zero points for consumer.

The sensible sales tax structure is not per se broad or narrow, but is focused on household consumption expenditure.

An overall index for each state sales tax was calculated from the scores for each individual feature. Because the scores for the features are scaled differently, each measure was converted to a t-score (mean of 50, standard deviation of 10) so that adding the scores would be meaningful. In calculating the total scores, the indices for household consumption inclusion and business purchase exemption were double-weighted and the index for type of tax was given a half-weight. Table 2 reports the composite index for each state and presents both the raw and adjusted (t-score) measures for each state.

The 10 highest-scoring states — in other words, those whose sales taxes are graded to be the best — are, from the top down, Oklahoma, West Virginia, Utah, Virginia, Idaho, Wisconsin, Alabama, Illinois, Kansas, and Ohio. The 10 lowest-scoring states, those whose taxes are graded to be the worst are, from the bottom up, Vermont, New Jersey, Rhode Island, North Carolina, Connecticut, Nebraska, Minnesota, Louisiana, Mississippi, and North Dakota.[9] According to the standards established earlier in this paper, these would be among the best and worst sales tax structures in the United States. The region with the highest average index (best sales tax structure) is the Rocky Mountain, followed closely by the Great Lakes; the region with the lowest average index is New England. Unfortunately, the states have not appeared to learn over time: The sales taxes in the lowest-scoring states are somewhat newer than those in the higher-scoring states, with average ages of 54 and 61 years. The correlation between age and structure rating is 0.2193, so older states in general tend to have better structures. But even the best structures miss the ideal: If a state received the highest possible score for each element of structure, its score would have been 526.66, so even the states at the top of the scale reported here have structures that score well below that level.

No states achieve the policy standard of a uniform, neutral tax levied on household consumption expenditure, and even those with the best structures fall considerably below the ideal.

The states with structures closest to the ideal are neither the narrowest nor the broadest, nor are they the ones relying most or least heavily on the sales tax, nor are they clearly the states with highest or lowest sales tax effort. Table 3 (p. 133) reports the breadth, effort, and reliance for each state sales tax. First, the mean breadth of base as measured by the ratio of the implicit sales tax base to state personal income is roughly the same for the 10 highest and 10 lowest scoring states — 39.7 percent for the highest and 41.6 percent for the lowest. Having a well-structured sales tax does not mean that the tax will be overall broader or narrower in coverage; the sensible structure is not per se broad or narrow, but is focused on household consumption expenditure. Second, the scores bear a modest relationship to sales tax effort as measured by sales tax collections relative to state personal income. The effort for the 10 states with the highest rank was 2.01 percent of personal income, compared with 2.31 percent for the 10 lowest. Effort is somewhat lower for states with a better sales tax structure. Third, the ratings are not closely linked to reliance on the sales tax for state tax revenue as measured by sales tax collections relative to total tax collections. Mean reliance for the 10 highest-ranked states is 32.9 percent, compared with 34.2 percent for the 10 lowest ranked. Reliance appears to be just slightly lower for states with well-structured sales taxes as it is for those with poorly structured taxes.

Conclusion

Two points are clear in this evaluation of states sales tax structures according to the standards of sound tax policy. First, no states achieve the policy standard of a uniform, neutral tax levied on household consumption expenditure, and even those with the best structures fall considerably below the ideal. States do vary widely in the extent to which they are consistent with sound sales tax policy, however, and some are much closer to the ideal than are others. All have considerable scope for improvement if they are to fulfill the full promise of a uniform tax on consumption.

Second, the indices vary widely across the states for the simple reason that state sales tax structures vary widely. There is no uniform structural definition of the U.S. retail sales tax. Lacking a national model, state lawmakers have gone their separate ways in tax design. While this is absolutely consistent with the idea of fiscal autonomy in a federal system, the

[9] The few states at the top and bottom of this list retain that ranking through several different schemes of rating and weighting the scores.

variation makes any attempt to levy a national sales tax as a piggyback to the state taxes a folly in terms of economic, fiscal, and equity effects.

Others may devise alternate evaluation indices that add additional structural components, work against somewhat different standards, or provide different weighting to the structural components. And, of course, the indices will change as lawmakers change their sales tax structures. However, the indices presented here attempt a start at a more fundamental consideration of how states might restructure their sales taxes to come closer to the ideal of a tax on consumption and how far states are now from that standard. ☆

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Special Report / Viewpoint

Sales Taxation of Business Inputs: Existing Tax Distortions And the Consequences of Extending The Sales Tax to Business Services

by Robert Cline, John L. Mikesell, Thomas S. Neubig, and Andrew Phillips

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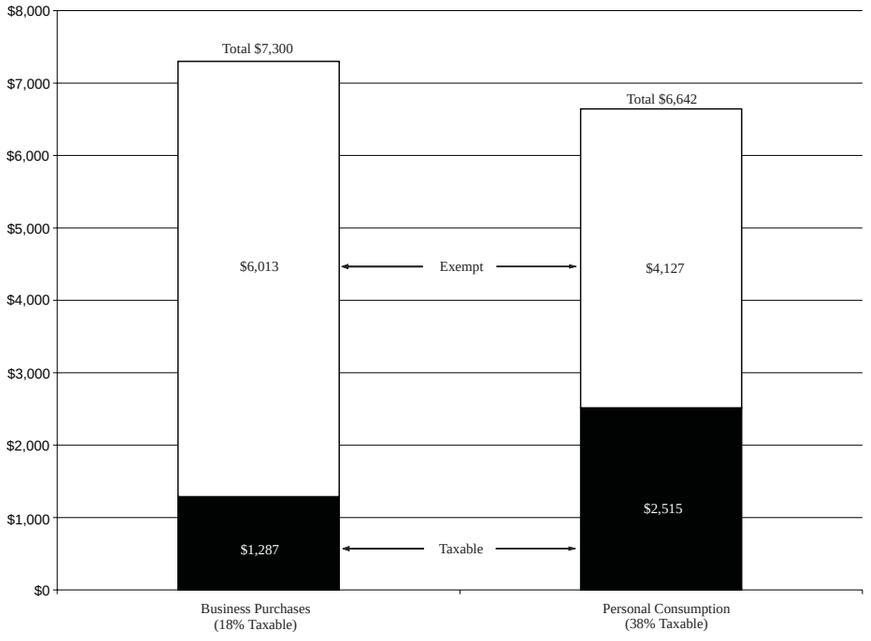
This report was prepared for the Council On State Taxation. COST is the premier state tax organization representing taxpayers. It is a nonprofit trade association consisting of approximately 575 multistate corporations engaged in interstate and international business. COST's objective is to promote and preserve equitable and nondiscriminatory taxation of multijurisdictional business entities.

Executive Summary

The Council On State Taxation requested that Ernst & Young LLP analyze the current sales tax on business purchases, as well as the economic effects of a proposed extension of the sales tax to business services. Our findings include the following:

- The current state and local sales tax differs from a true or ideal retail sales tax. A true retail sales tax would impose a uniform tax only on final consumption — all goods and services sold to households — but would not impose any tax on business purchases of intermediate goods and services. The current sales tax system imposes over $100 billion in taxes on business purchases of business inputs and investments. This type of tax has significant adverse state economic development implications.
- A number of states are considering extending the sales tax to more services. Unless carefully designed, an extension of sales tax to many services would exacerbate the current economic distortions from the sales tax on business inputs.
- The current sales tax on business inputs violates several tax policy principles (economic growth, efficiency, equity, simplicity) and causes numerous economic distortions. The distortions are caused by what economists call "pyramiding": The tax is imposed at multiple levels, such that the effective tax rate exceeds the retail sales tax rate. Most states make some attempt to reduce the pyramiding of their sales tax, but those efforts are far from complete.
- A sales tax on business inputs is an additional cost of doing business in the state, forcing companies to either attempt to pass on that cost to their customers or reduce their economic activity in the state. A sales tax on business inputs imposes a particular burden on in-state businesses selling in regional or national markets, because they are less able to pass on the added cost to customers and thus are likely to reduce their activity in the state. As a consequence, these businesses may reduce their in-state investment in equipment and buildings and create fewer jobs for state residents.
- Currently, most states do not tax services principally purchased by business because of the pyramiding and complexity it would create. A recent proposal to impose sales and use tax on certain services in Texas exemplifies the problems that would be caused:
  - Eighty-seven percent of the additional static tax revenue would come from business purchases of services.
  - Companies would be encouraged to self-provide those business services to avoid the tax rather than purchasing them from more efficient providers and paying tax.

Figure 1
Level and Taxability of All Business and Household Purchases
(2003; Dollars in Billions)



- Texas companies selling in international, national, and regional markets would be put at a competitive disadvantage to many of their competitors, leading to a reduction in investment and employment in the state.
- The proposal unfairly and inefficiently taxes some products and services more than others by imposing varying degrees of tax on inputs in addition to a general tax rate on final sales.
- The proposal also unfairly hides the true cost of government services by embedding a portion of the sales tax in the final price of goods and services.

States that are considering reforms to their sales tax systems need to carefully examine the economic development implications of their current taxation of business purchases. Proposals to extend the sales tax to services could further exacerbate the adverse economic distortions from the current taxation of business purchases.

The Current Sales Tax: Diverging From a True Retail Sales Tax

The current state and local sales tax system is similar to an iceberg. Not only is it a slowly drifting accumulation of many years of legislative actions, but also a large portion is hidden from view. The current sales tax is not grounded in the rock-solid tax policy principles of fairness, simplicity, equity, and efficiency. Over 40 percent is submerged by the taxation of business inputs, whose cost is generally hidden and unrecognized in the form of higher consumer prices or reduced state economic development. The current system is a clear impediment to state economic development efforts and a drag on companies subject to the complex system of state taxation.

It is important to understand the current system of state and local sales and use taxes and their current taxation of business purchases before analyzing the implications of extending the sales tax to business services.

Current State of the Retail Sales Tax

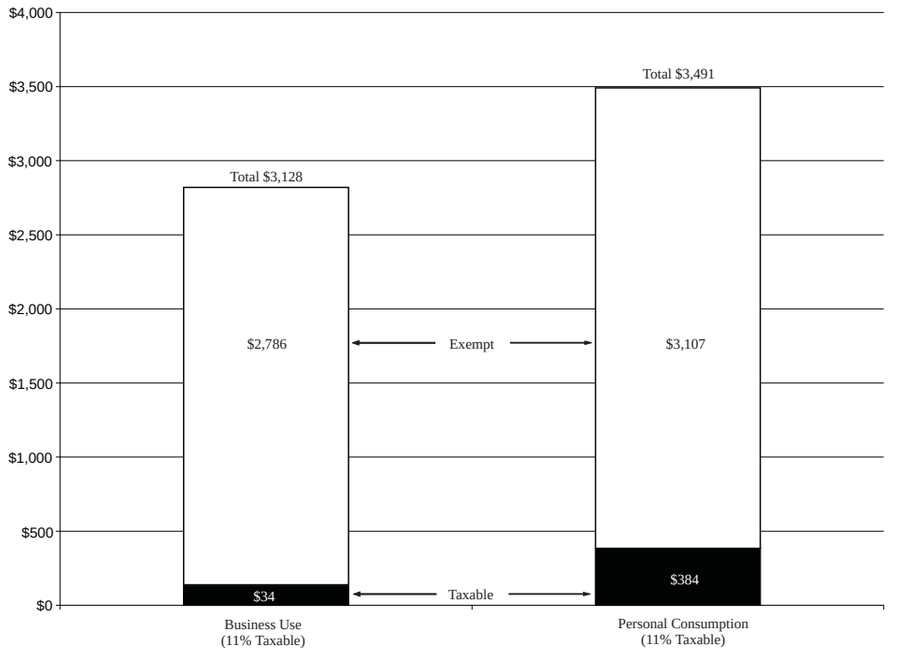
The retail sales tax, ideally, is a tax on final consumption by households. It is designed to tax final consumption by applying the tax to the final sales in the production and distribution of goods and services. In practice, the retail sales tax falls short of taxing the broad base of household consumption, while falling heavily on many business purchases. The current undertaxation of household consumption and overtaxation of business inputs, relative to a true retail sales tax, creates complexity and economic distortions.

Figure 1 shows the relative magnitude of both the amount of business and consumer purchases and their potential sales tax bases:

- Personal consumption expenditures in the United States totaled $6.6 trillion in 2003, of which an estimated 38 percent was subject to sales tax.[1] States exempt large segments of consumer purchases, including most medical and educational purchases, plus numerous other retail goods and services. Over $4 trillion of household purchases are exempt. Sales tax collections from household purchases totaled $133 billion.

[1] This figure excludes expenditures for housing.

Figure 2
Level and Taxability of All Business and Household Purchases of Services
(2003; Dollars in Billions)



- Business purchases totaled $7.3 trillion in 2003, exceeding final household consumption expenditures, because of multiple business-to-business sales between companies involved in the production and distribution process. The current sales tax overtaxes business purchases, falling on about 18 percent of business purchases, because most states have incomplete sale-for-resale and limited business purchase exemptions. The $1.3 trillion of business purchases that are currently taxed would not be taxed under an ideal retail sales tax.

Figure 2 shows the level of sales tax on *services* purchased by business and households:

- Personal consumption service expenditures in the United States totaled $3.5 trillion in 2003, of which an estimated 11 percent was subject to sales tax. States exempt most services, including most medical and educational services. Taxable services represent 15 percent of the existing personal consumption sales tax base.
- Business purchases of services totaled $3.1 trillion in 2003. The current sales tax overtaxes business purchases of services, falling on about 11 percent of business purchases. Taxable services represent 27 percent of the existing business purchases sales tax base.

The Extent of Sales Taxation Of Business Purchases

Although a pure retail sales tax would be imposed only on retail purchases by consumers, a significant percentage of retail sales taxes are now imposed on business input purchases. Table 1 (next page) provides state-by-state estimates of the percentage of total state and local sales taxes imposed on business purchases.[2] For each state, the table presents estimates of sales taxes paid on business purchases and household consumption. In addition to the dollar amounts, the table includes the business share of total state and local sales taxes.

In fiscal 2003, state and local sales taxes on business purchases, including intermediate inputs and capital investments, totaled $100.1 billion.

In fiscal 2003, state and local sales taxes on business purchases, including intermediate inputs and capital investments, totaled $100.1 billion. The national average business share of all general sales taxes was 43 percent. The business shares

(Text continued on p. 461.)

[2] The estimates of sales taxes paid by business on their purchases are derived from the E&Y 50-state sales tax model. The model includes state-specific industry-by-industry flows of business intermediate input and investment purchases based on national input-output relationships and state output estimates. The model also includes estimates of household purchases by category of spending. A separate sales tax matrix was developed for each state to reflect the current-law sales tax treatment of business and household purchases by detailed categories of commodities and services. Applying the tax matrix to levels of transactions produces estimates of total sales and use taxes on business intermediate inputs, business investment purchases, and consumer expenditures. The general sales tax figures include retail sales taxes and the general gross receipts taxes in several states, including Washington, New Mexico, and Hawaii. In Washington the estimates include both the retail sales tax and the business and occupation (B&O) tax on gross receipts.

Table 1
Business Share of Total State and Local General* Sales Tax Collections
(Fiscal 2003; Dollars in Billions)

State	Business Sales Tax	Consumer Sales Tax	Total Sales Tax	Business Share
Alabama	$1,146	$2,039	$3,185	36.0%
Alaska	n/a	n/a	n/a	n/a
Arizona	2,769	3,129	5,898	47.0%
Arkansas	837	1,738	2,575	32.5%
California	14,871	18,113	32,984	45.1%
Colorado	2,092	2,141	4,233	49.4%
Connecticut	1,570	1,603	3,173	49.5%
Delaware	n/a	n/a	n/a	n/a
Florida	5,304	10,353	15,657	33.9%
Georgia	3,666	4,762	8,428	43.5%
Hawaii	542	1,139	1,681	32.2%
Idaho	233	596	829	28.1%
Illinois	3,230	4,492	7,722	41.8%
Indiana	153	1,686	3,959	32.5%
Iowa	789	1,231	2,020	39.1%
Kansas	1,063	1,362	2,425	43.8%
Kentucky	1,104	1,306	2,410	45.8%
Louisiana	3,388	1,682	5,070	66.8%
Maine	323	549	872	37.1%
Maryland	1,151	1,653	2,804	41.0%
Massachusetts	1,544	2,309	3,853	40.1%
Michigan	2,606	5,508	8,114	32.1%
Minnesota	1,727	2,212	3,939	43.8%
Mississippi	915	1,525	2,440	37.5%
Missouri	2,029	2,489	4,518	44.9%
Montana	n/a	n/a	n/a	n/a
Nebraska	686	649	1,335	51.4%
Nevada	945	1,353	2,298	41.1%
New Hampshire	n/a	n/a	n/a	n/a
New Jersey	2,452	3,799	6,251	39.2%
New Mexico	1,008	813	1,821	55.3%
New York	9,166	9,049	18,215	50.3%
North Carolina	1,880	2,807	4,687	40.1%
North Dakota	177	233	410	43.2%
Ohio	3,454	4,573	8,027	43.0%
Oklahoma	1,408	1,310	2,718	51.8%
Oregon	n/a	n/a	n/a	n/a
Pennsylvania	3,057	4,775	7,832	39.0%
Rhode Island	375	388	763	49.2%
South Carolina	837	1,713	2,550	32.8%
South Dakota	366	342	708	51.7%
Tennessee	2,205	4,134	6,339	34.8%

(Table 1 continued next page.)

(Table 1 continued)				
State	**Business Sales Tax**	**Consumer Sales Tax**	**Total Sales Tax**	**Business Share**
Texas	9,108	9,967	19,075	47.7%
Utah	707	1,345	2,052	34.4%
Vermont	88	136	224	39.5%
Virginia	1,322	2,463	3,785	34.9%
Washington	5,553	4,064	9,617	57.7%
West Virginia	285	719	1,004	28.4%
Wisconsin	1,615	2,458	4,073	39.7%
Wyoming	308	268	576	53.6%
U.S. Total	**$100,055**	**$133,093**	**$233,148**	**42.8%**

*Does not include specific or selective excise taxes or Alaska's local sales tax.
Source: E&Y 50-State Sales Tax Model for 2003.

(Text continued from p. 459)

varied from 28 percent in Idaho and West Virginia to 67 percent in Louisiana and exceeded 50 percent in eight states.

To put those estimates in perspective, state corporate income tax collections in fiscal 2003 were an estimated $34.6 billion. Sales tax on business inputs was almost three times larger than state corporate income taxes.[3] State and local retail sales taxes, in practice, impose substantial tax burdens on business purchases, increasing the operating and capital costs of doing business in a state.

The extensive taxation of business inputs creates a number of equity, efficiency, and competitiveness issues that are discussed in detail in this study. That businesses already pay 43 percent of all sales taxes, and that those taxes can have significant adverse state economic development effects, must be kept in mind as state legislators consider broadening the sales tax base to include services that are predominantly purchased by business.

Pyramiding of the Sales Tax

In theory the retail sales tax is designed to tax final consumption of goods and services. In other words, the tax should be imposed only on the purchase of taxable sales by households while exempting business purchases. In practice, typical state and local sales taxes are imposed on a significant portion of business-to-business sales. That results in problems, including distortions in how firms operate, arbitrary and hidden differences in effective sales tax rates on different goods and services that distort consumer choices, violations of horizontal and vertical equity principles, and detrimental effects on a state's business competitiveness.

Those problems are partially a result of the *pyramiding* of the retail sales tax. In this study, sales tax pyramiding refers to the situation in which the same goods and services are taxed multiple times as they move from production to final retail sale. That occurs, for example, when the cost of a taxable product or service sold by one business to another is embedded in the price of the purchasing firm's taxable sales.

Table 2 (next page) contrasts sales taxes imposed (at 6 percent) under an ideal sales tax applied only to final retail sales with a typical state sales tax that also taxes a portion of business-to-business sales. The table shows the final stages in the production and distribution of consumer appliances. In the example, a computer manufacturer sells computers to both the manufacturer of appliances and the retailer; the appliance manufacturer sells only to the retailer. A properly designed, ideal retail sales tax would only apply the 6 percent tax rate to the final $700,000 of sales to consumers, yielding $42,000 in tax collections.

The typical sales tax in most states taxes a portion of the inputs purchased by the appliance manufacturer and the retailer, although it generally exempts the purchase of computers used in the manufacturing process and the sales of appliances to the retailer through manufacturing and sale-for-resale exemptions. In this example, $170,000 of computer sales that are not directly related to the manufacturing process are taxed. At 6 percent, the sales tax on the computer purchases generates an additional $10,200 of tax. In effect, the value of the nonmanufacturing computers is taxed twice. As shown in the last line of the table, the effective sales tax rate (taxes divided by final retail sales of $700,000) in the typical state example is 7.5 percent. That is 25 percent higher than the ideal retail sales tax rate of 6 percent. The extra tax is a measure of the pyramiding occurring in the sales tax system.[4]

Economic Distortions and Effects On Competitiveness of Pyramiding

Pyramiding from taxes on business inputs affects interstate business tax competitiveness, economic efficiency, and tax equity.

- Different final products are subject to varying effective tax rates. This distorts consumer choices, penalizing the purchase of goods and services subject to higher effective tax rates.

[3] Estimates of business taxes by tax type are from "Total State and Local Business Taxes: A 50-State Study of the Taxes Paid by Business in Fiscal 2003," *State Tax Notes*, Mar. 1, 2004, p. 737, *2004 STT 40-4*, or *Doc 2004-1774*, study prepared by Ernst & Young LLP for the Council On State Taxation (January 2004).

[4] To simplify the example, we have not included the "tax-on-a-tax" that is also part of the pyramiding process. In that case, the 6 percent retail tax on the tax already paid on the purchase of the taxed computers ($36.72) would add to the calculated amount of pyramiding. It should be noted that a value added tax is a form of retail sales tax that avoids pyramiding by eliminating the tax on business inputs.

Table 2
Example of Pyramiding Under a Retail Sales Tax

Sales To:	Sales By:			Sales Tax at 6%	
	Computer Manufacturer	Appliance Manufacturer	Retailer	Typical State	Ideal Tax
Appliance Manufacturer:					
Computers used in manufacturing	$30,000			$0*	$0
Office computers	$150,000			$9,000	$0
Retailer:					
Office computers	$20,000			$1,200	$0
Appliances		$600,000		$0†	$0
Final Consumers:			$700,000	$42,000	$42,000
Total Sales Tax				**$52,200‡**	**$42,000**
Effective Tax Rate on Retail Sales				**7.5%**	**6%**

* Exemption provided for computers used in manufacturing process.
† Exemption provided for purchases of appliances for resale.
‡ Does not include tax on tax.

- The sales tax imposed on business-to-business sales can encourage businesses to vertically integrate to avoid taxable transactions, even if it involves additional costs that reduce the value of a state's economic output.
- To the extent a state taxes a greater percentage of business purchases and imposes a higher sales tax rate on those purchases, in-state businesses face higher costs of production that cannot, most likely, be passed along in higher prices to out-of-state buyers. That puts in-state businesses at a competitive disadvantage and reduces economic growth.

It should be noted that the problems associated with pyramiding of the retail sales tax affect firms producing services as well as goods. Although states have been more cautious in extending the sales tax to the purchase of business and household services, they have also denied sale-for-resale and other exemptions that would reduce the sales taxes paid by service firms on their taxable input purchases. Issues involved in taxing services purchased by business are discussed later in this report.

Magnitude of Pyramiding

The hidden tax on business purchases, or pyramiding, results in an additional tax on final consumer goods. For example, a recent study by the Washington State Tax Structure Study Committee found that the Washington state business and occupation tax, which is a gross receipts tax, pyramids an average of 2.5 times.[5] In other words, $1 of initial tax on an industry's sales results, on average, in $1.50 in additional taxes from pyramiding.

While states have reduced pyramiding of the retail sales tax with sale-for-resale and manufacturing exemptions, significant pyramiding still occurs in the sales tax system. Nationally, the current sales tax system imposes an effective tax rate of 1.27 percent on final retail sales, both taxable and nontaxable, because of the numerous exemptions of final retail sales. However, the total effective tax rate, including the sales tax on business purchases, is 2.19 percent, or 1.72 times the average nominal sales tax rate. That occurs because 43 percent of the sales tax falls on business purchases.

While educational and health services are generally exempt from sales taxes, an estimated $4 billion in state and local sales taxes are imposed on inputs used in those industries.

The extent of pyramiding varies by industry and by type of goods and services purchased, and will also vary by state. Table 3 (next page) shows the extent of pyramiding for selected consumer goods and services on a national basis. Pyramiding results in total effective tax rates far in excess of the nominal sales tax rate on certain goods. For example, sales of motor vehicles have an average sales tax rate of 3.4 percent; however, sales tax on business purchases results in another 0.9 percent sales tax embedded in motor vehicle prices. As a result, the total effective tax rate is 4.3 percent. The pyramiding rate is 1.3.

Hidden taxes on input purchases also result in indirect sales taxes on goods and services that are nominally "exempt" from the retail sales tax. For example, while educational and health services are generally exempt from sales taxes, an estimated $4 billion in state and local sales taxes are imposed on inputs used in those industries.

Finally, state-by-state variations in the extent of sales taxation of business inputs are important for evaluating the potential economic competitiveness effects of the current sales tax. The sales tax paid on business purchases is an origin-based tax paid at the location of the producer. The sales tax paid by the consumer on the price of the final retail purchase is a destination tax; it is imposed on the good or service regardless of where

[5] Washington State Tax Structure Study Commission, *Tax Alternatives for Washington State: A Report to the Legislature*, November 2002, pages 110-112. The gross receipts tax applies to all business sales, not just retail sales to final consumers.

Table 3
Estimated National Pyramiding and Resulting Sales Tax Rate Nonuniformity

Commodity	Embedded Tax	Tax on Final Sales	Total Tax Rate	Pyramiding Index
Extraction and Utilities				
Agricultural Products	1.7%	1.5%	3.3%	2.1
Oil and Gas Extraction	6.7%	4.9%	11.6%	2.4
Electric, Water, Gas	1.2%	2.9%*	4.0%	1.4
Nondurable				
Food and Beverage	0.5%	1.4%*	1.9%	1.3
Textiles and Apparel	1.5%	2.4%	3.8%	1.6
Paper Products	3.8%	2.6%	6.4%	2.5
Petroleum and Chemical Products	2.3%	3.0%	5.2%	1.8
Durable				
Primary and Fabricated Metals	3.1%	0.2%	3.3%	14.9
Machinery	0.8%	3.5%	4.2%	1.2
Computer Equipment	0.9%	2.6%	3.5%	1.3
Electrical Equipment	1.7%	2.9%	4.5%	1.6
Motor Vehicles and Parts	0.9%	3.4%	4.3%	1.3
Furniture and Miscellaneous	1.2%	3.6%	4.8%	1.3
Services				
Information and Telecommunications	2.3%	1.4%*	3.7%	2.7
Financial Services	0.8%	0.1%	0.9%	9.9
Professional and Business Services	3.1%	0.2%	3.3%	14.9
Entertainment, Meals, and Lodging	0.9%	4.4%	5.4%	1.2
Repair, Maintenance, and Cleaning	0.1%	0.3%	0.4%	1.2
All Commodities and Services	**0.9%**	**1.3%**	**2.2%**	**1.7**
Note: Exempt at Final Sale				
Educational and Health Services	0.2%	0.0%	0.2%	—
Construction	1.6%	0.0%	1.6%	—

Source: E&Y calculations based on Bureau of Economic Analysis input-output data and 2003 sales tax rates researched by E&Y.
*Certain commodities, such as electricity, alcoholic beverages, and telecommunications, are subject to additional, commodity-specific, and substantially higher taxes than the general sales tax. For example, see Council On State Taxation, *2001 State Study and Report on Telecommunications*.

the good or service was produced. Thus, a sales tax imposed on the production of paper products in Wisconsin will increase the cost of a Wisconsin producer, who may not be able to pass along that Wisconsin-specific tax to customers in Minnesota, Florida, or Germany. Even if the Wisconsin producer can pass the tax forward in a higher price, that could reduce the total amount of sales the producer could make. If it cannot pass the tax forward, the company and its workers will receive less than they would in certain other states.

The Economic Effects and Administrative Complexities of Taxing Business Services

The problems inherent in the current sales tax systems will be magnified if the retail sales tax is extended to services that are predominantly consumed by business. This section discusses the issues related to applying state and local sales taxes to business services.

States have been reluctant to extend the sales tax to business services, including professional services provided by lawyers, accountants, technology consultants, and engineers. South Dakota and Connecticut appear to be the only states that tax a significant number of professional services (excluding advertising and medical care) under a retail sales tax. Hawaii and New Mexico impose gross receipts taxes that in practice are similar to a retail sales tax on most professional services.

There are important reasons why almost all states have chosen not to impose a retail sales tax on business services, including: the challenge of determining where the use of services occurs and the potential for multiple taxation, the economic distortions and inefficiencies that are created by pyramiding of the sales tax on business services, and the detrimental effect of taxing business services on a state's economy. The following sections discuss the problems and issues in imposing sales taxes on business purchases in more detail.

Arbitrary Determination of Where Services Are Used

A significant issue in extending the retail sales tax to services, whether purchased by business or consumers, is how to determine where a service is "used" or consumed.[6] This determination is much more complicated for services than for sales of tangible personal property. For goods, retail sales tax systems are generally structured as destination-based taxes. In other words, the tax is imposed in the state where goods are used or consumption occurs. If goods are purchased from an out-of-state vendor, a "use" tax is imposed on the consumer if the vendor has not collected a state's retail sales tax. The location of consumption is generally where the product is delivered. Therefore, consistent with the destination approach, states generally exempt sales to out-of-state customers. Those customers are instead generally liable for tax in the state in which the good is ultimately used.

For business services, it is difficult to determine the location or situs of the consumption.

For business services, it is much more difficult to determine the location or *situs* of the consumption. In many cases, such as legal services, computer processing, or consulting services, the services can be contracted for in one state, performed in a second state, delivered to a client in a third state, and then distributed by the client to business locations in additional states. The delivery will often take the form of electronic transfers of information and documents. The fundamental question in this situation is: Where is the service used and where does the taxable sale occur?

South Dakota's approach to taxing legal services illustrates the challenges in imposing a state transaction tax on mobile, professional services.[7] Here is a description of how it works: An out-of-state law firm must charge and collect the South Dakota sales tax on its entire legal fees if the client resides or has nexus in South Dakota; the legal matter involves in-state property, events, or in-state transactions; and the attorney enters South Dakota or makes an appearance in the state, but physical entry is not necessarily required. If all three conditions are not met, the tax is determined by actual work and time in South Dakota. If an in-state company purchases legal services from outside the state, a use tax is due from the purchaser (if the provider does not collect and remit the sales tax). If an in-state lawyer sells services that are used entirely outside South Dakota, no sales tax is due in South Dakota. Also, there are extensive rules to determine when a sale of services is exempt as a purchase for resale.

Florida's brief experiment for six months in 1987 with applying the general sales tax to services further illustrates the difficulty in determining where services are consumed and how to impose a use tax effectively on out-of-state purchases. Because an estimated 70 percent of the anticipated revenue from expanding the sales tax to services was from business services, that became the focal point for opponents of the tax.[8] In reality, the heated Florida debate was a debate about business taxation.

Florida adopted an entirely new method of determining the location of the use of business services for purposes of imposing the retail sales tax. For services directly related to property, such as construction and maintenance services, the location of the property determined where use occurred. But for general business services purchased by multistate businesses, Florida's unique approach borrowed the concept of formula apportionment from the state's corporate income tax.

Under the Florida approach, business services were "presumed" to be used in Florida in proportion to the profits earned in the state, and Florida's three-factor formula for apportioning corporate income was adopted to determine where the use took place.[9] The apportioned services included general legal, accounting, data processing, and management services. In effect, Florida argued that just as net income of a multistate company earned in a specific state cannot be known but only apportioned by arbitrary factors, use of business services, other than services directly related to real and personal property, cannot be known for a specific state but can only be apportioned by arbitrary factors.[10]

Florida's adoption of the net income formulary apportionment to divide the use of business services among the states is a testimony to the arbitrariness and lack of theoretical justification for including business services in a retail sales tax system.

Florida's adoption of the net income formulary apportionment to divide the use of business services among the states is a testimony to the arbitrariness and lack of theoretical justification for including business services in a retail sales tax system. The business service tax adopted a broad use tax levied on purchasers of business services instead of the traditional retail sales tax collected and remitted by sellers of services. That is, Florida created another general business tax, based on apportioned business service expenses, within the state retail sales tax structure.

[6] The following discussion assumes that states have defined what a service is and can distinguish between tangible personal property (goods) and services. States continue to struggle with those distinctions. For example, the Streamlined Sales Tax Project appears to have reached an impasse in its efforts to distinguish between tangible and intangible computer products and computer services. For another example, states have not been able to reach agreement on whether electricity is a tangible product or a service. Those differences add to complexities and compliance costs in the sales tax system.

[7] See Commerce Clearing House, *South Dakota State Tax Reporter*.

[8] James Francis, "The Florida Sales Tax on Services: What Really Went Wrong?" in Steven D. Gold, ed., *The Unfinished Agenda for State Tax Reform* (November 1988), p. 136.

[9] The weighted apportionment percentage was applied to the sales price of services to determine the taxable sale in Florida. For example, if 10 percent of a company's profits were apportioned to Florida (based on the three-factor apportionment percentage), 10 percent of business purchases of services were assumed to be in Florida.

[10] The Florida apportioned use tax provisions borrowed other concepts from the state corporate income tax, including the sourcing of services (where the greater proportion of services occurs).

The resulting hybrid tax system was strongly criticized by business as creating very high compliance costs relative to the taxes collected. Firms had to segregate purchases of business services into those assigned to Florida and those apportioned to Florida and other states. Compliance required accounting and tax compliance systems that looked more like those used under a corporate income tax than a retail sales tax.[11] While it is not clear what type of tax it was, it was anything but a retail sales tax collected by the seller on final sales to household consumers.

A former Minnesota commissioner of revenue succinctly commented on the advisability of that novel approach to sales taxation of business services:

> Expecting the buyer of services to keep records apportioning their benefit among multiple states and to pay tax on each purchased service would be absurd — absurd in effort and cost for the taxpayer relative to the benefit to the states and absurd in expectably low compliance, which would foment wider disrespect for the law.
>
> The conclusion is simple: if you believe that you are in a situation in which apportionment of sales tax among jurisdictions is in order, it is time to start thinking about a different mode of taxation. Apportionment of a transaction-based tax like the sales tax is grossly inappropriate.[12]

An important tax policy issue directly related to the difficulty in determining where business services are used is the very real possibility of multiple taxation of basically the same transaction by different states. That outcome can be illustrated by using the earlier example of determining the situs of business services. A legal firm with offices in state A may sign a contract in state B to provide and deliver services to a multistate manufacturer with headquarters in state C. The headquarters may then distribute the results of the legal analysis electronically to two affiliates located in state D and state E.

Based on the different approaches that states have taken to determine where taxable sales of services occur, the same legal services in this example may be taxed simultaneously in five different states as follows: state A may tax the transaction based on where the services are performed; state B may tax it based on where a contract is signed; state C may tax it based on the point of delivery of the services; and states D and E may both tax the transaction based on where the services are used. Combined with the fact that states may not provide credits for sales taxes paid in other states on services, the legal services could be taxed multiple times.

The key point here is that it is extremely difficult to determine where business services are consumed and, therefore, how to determine which states impose sales and use taxes on service transactions and which states provide offsetting tax credits to avoid multiple taxation. Ad hoc approaches to deal with those problems quickly lead away from the retail sales tax to a new, additional system of business taxation.

As discussed below, before extending the sales tax to business services, states should carefully consider the potentially significant negative effects on a state's economic competitiveness, in addition to the complexity and administrative and compliance burdens involved.

Tax Pyramiding or Cascading

The second major problem with taxing business services is the pyramiding of the tax. As illustrated earlier, pyramiding (sometimes referred to as cascading) results in the sales tax being imposed multiple times on the same goods and services as inputs move through the production and distribution chain. Pyramiding results in final sales of different products and services bearing different amounts of sales tax per dollar of sales. The resulting variation in effective tax rates distorts consumption choices, encourages vertical integration by businesses to avoid taxable transactions, and produces unintended and unknown distributional effects.

Public finance economists and state tax administrators understand that a properly designed retail sales tax should be applied only to final consumer purchases, not intermediate input purchases by businesses. The objective is to tax final consumers, not businesses. Over time, states have adopted a number of sales tax features to reduce the level of taxation of business purchases of tangible personal property. Those include exemptions for sale for resale, for materials consumed in production, and for materials that become an integral part of a product.

While those limited provisions are consistent with the guiding principle of taxing only final sales, states have not adopted general sales tax exclusions for business input purchases, primarily because of the significant reduction in taxes that would result from those exclusions. In some cases, legislators have chosen to tax inputs purchased by firms, such as healthcare providers, as an indirect way to tax services (healthcare, for example) that are intentionally exempted from direct sales taxation for public policy ("equity") reasons.

These exemptions are a fundamental feature of the retail sales tax, but are much more difficult to administer in the case of business services.[13] If exemptions are not provided for business purchases of services, the problems associated with pyramiding will be magnified. For example, larger companies could hire in-house lawyers, accountants, and other professionals and avoid paying the sales tax, leaving small or medium-size firms subject to paying the sales tax on their service purchases from other firms.[14]

[11] See James Francis, "The Florida Sales Tax on Services," *supra* note 8, for a detailed discussion of the structure of the business services tax. Special formulas were adopted to apportion advertising and transportation services to Florida. For individual consumption of services, the new system assigned the sales to the state where the greatest proportion of the cost of providing services was incurred. Again, this is a concept used in sourcing sales in the corporate profits tax apportionment formula. It should also be noted that the Florida legislation imposing the sales tax on services did not define the term "taxable services." Definitional challenges included whether interest paid to financial institutions is a payment for the service of lending money (and taxable as a service) or a payment for leasing property (and not taxable).

[12] John P. James, "Sales Tax on Services: A Tax Administrator's Perspective," in William F. Fox, editor, *Sales Taxation: Critical Issues in Policy and Administration* (1992), p. 73.

[13] See South Dakota Department of Revenue, *A Guide to Sales and Use Tax* (2002), "Sales for Resale" examples, p. 24.

[14] South Dakota subjects a comprehensive list of business services to the retail sales tax but provides limited sale-for-resale exemptions to reduce pyramiding. For example, if a law firm purchases professional services on behalf of a client, the purchase qualifies for a resale exemption if the service is delivered without any alteration or change. However, the services provided by the law firm to other businesses within South Dakota are taxable and can result in additional pyramiding. See South Dakota Department of Revenue, *A Guide to Sales and Use Tax* (2002), sales-for-resale examples.

Table 4
Business Share of Purchases of Services, 2003

Industry	Business Share of Purchases of Services	Total Purchases of Services ($billions)
Principally Business Purchases		
Advertising	98%	$175.3
Architecture and Engineering Services	96%	125.2
Employment Services	94%	88.6
Management and Technical Services	88%	89.8
Data Processing Services	84%	38.4
Accounting and Legal Services	71%	196.1
Securities and Investment Services	66%	194.9
Principally Household Purchases		
Automobile Repairs	26%	145.6
Personal Services	11%	96.5
Education Services	7%	131.4
Amusements and Recreation	5%	81.0
Medical Services	1%	889.5

Note: Calculated by E&Y from U.S. Bureau of Economic Analysis, U.S. Benchmark Input-Output Matrix, adjusted to 2003 levels. Business percent equals business purchases divided by total supply of the service.

Table 4 illustrates why pyramiding of the retail tax is a significant problem in taxing business services. The table presents national estimates of the percentage of different service categories purchased by business. The top four service categories (advertising, architecture and engineering, employment, and management and technical services) all have business shares that are 88 percent or higher. Retail sales taxes imposed on these services are almost exclusively taxes on business inputs and are likely to be passed along in higher prices to the purchasers of the services. If the sales of the firms buying the services are also taxable, the cost of the business service will be built into the price of other goods and services and the value of the services may be taxed multiple times.

Additional services — including data processing, accounting and legal, and securities and investment services — have business shares in excess of 65 percent. The business purchases of these services will exacerbate the current pyramiding problem. In contrast, the table shows several service categories that are predominantly purchased by households. These are the types of services that states have been slowly adding to retail sales tax bases consistent with the tax policy objective of extending the retail sales tax to more *household* services. So far, state legislators appear to understand that a sales tax on services primarily consumed by businesses is a distinctly different tax from the retail sales tax imposed on services primarily consumed by households.

The states' experience with gross receipts taxes provides an important lesson concerning the adverse effects of extending the retail sales tax to business services. As discussed earlier, four of the five states that tax business services extensively do so under a gross receipts tax. For Washington state, the gross receipts (business and occupation, or B&O) tax applies to most industries. Based on a comprehensive state tax study, the Washington State Tax Structure Study Committee recently recommended that the gross receipts tax be replaced. In its final report, the committee stated: "Our B&O tax is a dramatic violator of the principle of neutrality among like businesses. The pyramiding of this tax on goods as they move through the production chain is a fundamental problem that requires correction."[15]

Taxing business services under a retail sales tax without exempting purchases by business will create similar problems of pyramiding because of the high business shares of purchases. While states could adopt a complex system of exemptions for business purchases of services to avoid pyramiding, the resulting business service tax base would be substantially reduced by the exemptions. The tax policy question is whether the additional sales tax revenues justify the additional complexity and compliance and administrative costs of the expanded sales tax system. Without those exemptions, states could collect more revenue but at the cost of significant economic distortions and negative effects on a state's business tax competitiveness.

Negative Effects on Interstate Business Tax Competitiveness

Because of intensifying interstate (and international) competition for new business investments and additional jobs, states are increasingly concerned about the adverse effect of out-of-line state and local taxes on economic development. Extending the sales tax to business services could have a significant negative effect on a state's business tax competitiveness by increasing business costs due to the sales tax on input purchases (including the pyramiding effect) and by putting

[15] Washington State Tax Structure Study Committee, *Tax Alternatives for Washington State: A Report to the Legislature,* November 2002, p. 30. Alternatives considered by the committee were a value added tax and a goods and services tax with a credit for all intermediate business purchases. Either alternative would eliminate pyramiding and approximate a pure retail sales tax on final consumption with no tax on business purchases.

in-state businesses at a competitive disadvantage compared with out-of-state firms selling into the state.

How Sales Taxes on Business Inputs Affect Competitiveness

The effect of taxation of business purchases of products and services on a state's economic competitiveness was recently described:

> Businesses will be at [an] economic disadvantage in competition with states providing broader producer input exemptions and, of increasing significance, in competition on world markets with entities producing in VAT [value-added tax] countries that afford more complete exclusion of producer purchases. Embedded tax paid on production inputs will make the product relatively more costly in these comparisons.[16]

If a state extends the retail sales tax to business services, the competitive disadvantage will be magnified, particularly given the reluctance of states to extend even the limited current business input exemptions for the purchase of goods to the purchase of services. If other states do not impose retail sales taxes on services purchased primarily by business, companies selling into competitive regional, national, or international markets will not be able to pass that tax forward in higher prices to customers.

If those companies try to increase prices, they will lose significant sales to competitors in other states (or possibly other countries). The only option for a company in this situation to remain competitive is to reduce investment and jobs in the state imposing the taxes on business services. That will eventually shift the burden of the tax backward to labor in the state through lower wages and employment.[17] If this happens, "business" will not bear the burden of the tax on business services, but the state's residents will.

Extending the sales tax to business services could put in-state businesses at a competitive disadvantage compared with out-of-state firms selling into the state.

Note that this will adversely affect a state's competitiveness even if the state exempts exports of business services from the sales tax, as is normally the case for sales of tangible personal property. Out-of-state sales by companies selling any goods and services that require significant inputs of business services will be burdened by the cumulative amount of sales taxes on business services used throughout the production process.

For in-state companies selling to customers in the state imposing the sales tax on business services, the negative effect on competitiveness will occur through a different mechanism. As explained above, it is very difficult to impose an effective use tax on services produced in another state. Therefore, in-state providers of business services will not be able to increase in-state prices sufficiently to cover the sales tax liability on their sales. In effect, those in-state companies will be put at the same competitive disadvantage that many in-state retailers currently face because in-state customers do not pay sales or use tax on purchases of tangible personal property from remote sellers. The disadvantage could average 6 percent of gross sales. Once again, firms will have to reduce their employment in the state or lower employee wages (pass the tax backward) to remain competitive.

The in-state versus out-of-state competitiveness issue was one of the primary factors that caused Florida's Legislature to repeal the state's sales tax on services, only six months after it went into effect. The business community's opposition to the extension of the tax to services that fell primarily on business inputs was swift, loud, and ultimately successful. After repeal of the service tax, Florida replaced the lost revenue with an increase in the sales tax rate on the previous tax base.

In terms of competitiveness, a major criticism of the Florida tax on services was that the resale provisions of the Florida law were too narrow, resulting in substantial pyramiding that put Florida companies at a competitive disadvantage. The Florida law used a narrow definition of "final sale," considering a purchase to be nontaxable only if the item was specifically purchased for the consumption of some subsequent consumer.[18] Purchases of services consumed by a business in the general running of the business were considered taxable.

New Mexico is also confronted with the same competitiveness issues in taxing business services under the state's gross receipts tax. In effect, the gross receipts tax does not impose a use tax on the purchaser of taxable services from out-of-state suppliers. For most services, the out-of-state supplier pays the tax only on the portion of services actually provided within the state. That treatment puts in-state service providers at a competitive disadvantage. Also, New Mexico has only a limited sale-for-resale exemption for service providers.

Adverse Effects on New Investment

To understand better the negative effect of taxing business inputs under the retail sales tax, we have modeled the reduction in the after-tax rate of return on new investments in a state for representative firms in selected states and industries.[19] This approach applies the current-law sales tax provisions in the selected states to the balance sheet and income statement information of firms in specific industries.[20] By holding the financial and economic characteristics of the representative firms constant across the states, this approach makes it possible

(Text continued on p. 469.)

[16] John L. Mikesell, "Sales Tax Incentives for Economic Development: Why Shouldn't Production Exemptions Be General?" *National Tax Journal*, Vol. LIV, No. 3, p. 558.

[17] Assuming that capital investment is quite mobile among the states, those businesses cannot pass the tax backward to investors in the form of lower rates of return on capital.

[18] For example, the fees charged by a court reporter would be nontaxable only if that was expressly requested by a lawyer's client. If the client merely sought legal counsel, the fees charged by the court reporter to the law firm would be taxable.

[19] The representative taxpayer approach to business tax analysis is being used in several states. For example, see Wisconsin Department of Revenue, Division of Research and Policy, *Corporate Tax Burden Comparison: Paper Industry* (Aug. 23, 2004). As pointed out in this analysis, the results of these studies are sensitive to the assumptions about the characteristics of the representative firms.

[20] The analysis looks at seven types of industries, representing durable manufacturers, nondurable manufacturers, and service firms located in 11 different states. The method measures the effect of sales taxes over time for business investments. While the results cannot be extended to all industries and all states, they do provide insight into the relative size of sales taxes imposed on business inputs.

Table 5
Estimated Effect of Extending Sales Tax to Business Services
(Texas SB 1031, 2003; Dollars in Millions)

State	Current Law Business Sales Tax on Inputs	Change in Business Sales Tax	Total Proposed Business Sales Tax	Revenue Change Falling on Business Inputs
Alabama	$1,092	64%	$1,797	90%
Alaska	n/a	n/a	n/a	n/a
Arizona	2,175	36%	2,178	89%
Arkansas	847	51%	1,019	94%
California	14,868	42%	18,741	86%
Colorado	2,092	24%	2,132	86%
Connecticut	1,569	21%	1,674	76%
Delaware	n/a	n/a	n/a	n/a
Florida	5,374	41%	6,187	87%
Georgia	3,750	33%	4,285	88%
Hawaii	548	13%	415	81%
Idaho	234	61%	327	90%
Illinois	3,295	84%	5,936	89%
Indiana	1,285	69%	2,181	93%
Iowa	784	58%	1,090	93%
Kansas	1,089	39%	1,379	91%
Kentucky	1,116	56%	1,445	92%
Louisiana	3,431	35%	4,455	92%
Maine	322	28%	345	85%
Maryland	1,146	35%	1,640	81%
Massachusetts	1,523	66%	2,240	86%
Michigan	2,631	62%	3,871	91%
Minnesota	1,628	54%	2,396	91%
Mississippi	912	35%	1,053	90%
Missouri	2,088	33%	2,374	88%
Montana	n/a	n/a	n/a	n/a
Nebraska	692	20%	889	85%
Nevada	954	40%	1,210	92%
New Hampshire	n/a	n/a	n/a	n/a
New Jersey	2,450	64%	3,627	87%
New Mexico*	1,015	0%	1,015	n/a
New York	9,737	41%	12,731	82%
North Carolina	1,828	62%	3,048	91%
North Dakota	176	49%	215	95%
Ohio	3,458	50%	5,597	90%
Oklahoma	1,444	20%	1,645	83%
Oregon	n/a	n/a	n/a	n/a
Pennsylvania	3,079	62%	4,488	88%
Rhode Island	355	34%	402	85%
South Carolina	846	63%	1,171	86%
South Dakota	374	15%	333	91%

(Table 5 continued next page.)

(Table 5 continued)				
State	**Current Law Business Sales Tax on Inputs**	**Change in Business Sales Tax**	**Total Proposed Business Sales Tax**	**Revenue Change Falling on Business Inputs**
Tennessee	2,238	63%	3,160	93%
Texas	10,003	57%	15,405	91%
Utah	696	48%	854	93%
Vermont	89	90%	191	91%
Virginia	1,372	64%	1,857	89%
Washington	3,447	34%	2,773	89%
West Virginia	288	78%	543	89%
Wisconsin	1,631	50%	1,992	93%
Wyoming	308	62%	382	54%
U.S. Total	**$100,279**	**33%**	**$133,556**	**87%**

Source: Calculated by E&Y based on the E&Y 50-State Sales Tax Model for 2003.
Note: The Texas legislation would impose tax on specific types of revenue for each industry. The percentage of taxed revenue varies from about 4 percent of financial services revenue to roughly 75 percent of legal services. New Mexico currently imposes tax on an equal or greater percentage of those services and would not be significantly affected by the proposed tax law change.

(Text continued from p. 467.)

to isolate the effect of sales taxes on business purchases on the profitability of a new investment or business expansion in a state, a measure that can be easily understood and compared across states and tax types.

For the states and industries included in the comparison, the sales tax on business inputs averaged 31 percent of the total state and local tax burden on new investments for the included states and industries. In other words, the direct sales tax, assuming it is passed forward in higher input prices, accounts for almost one-third of the total state and local tax burden imposed on the representative taxpayers' new investment. The share of total taxes accounted for by the sales tax was highest in the service industries because they received relatively smaller resale and production sales tax exemptions, and, in some cases, were paying sales taxes on the purchase of services, such as computer services. Taxing business services more broadly would add to the effective sales tax rate.

As discussed earlier, a business taxpayer competing with out-of-state sellers in competitive markets is unlikely to be able to pass above-average sales tax burdens forward to consumers in higher prices. As a result, in-state firms put at a competitive disadvantage will have an incentive to invest in lower-tax states. As capital investment responds to the higher sales tax burdens, the tax burdens are shifted backwards to in-state labor and state economic growth is reduced.

Evaluating a Proposal to Extend The Sales Tax to Business Services

Many states faced with fiscal stress over the previous decade have reevaluated traditional sales tax base definitions and extended the sales tax to sales of selected services. Forced to choose between politically unpopular general sales tax rate increases and base-broadening options, most states have chosen base-broadening.

Given the potential high percentage of sales taxes on professional services that would be paid by in-state businesses, state policymakers should be concerned about the negative effect of these taxes on in-state businesses. If states cannot effectively enforce sales tax collection on out-of-state professional service providers, a tax on professional services could put in-state service providers at a competitive disadvantage that could be as high as 6 percent of gross sales. The sales tax on professional services is almost exclusively a tax on business inputs. Whether these taxes are paid by the businesses providing professional services or passed along in higher prices to other businesses, the sales tax on professional services should be considered principally a state business tax.

Example: Proposed Texas Expansion of Taxable Services

A 2004 legislative proposal in Texas, SB 1031, is used to illustrate the state-by-state effects of an expansion in the sales tax base to more services, and its implications for taxation of business inputs. Texas SB 1031 adds 14 enumerated services to the sales tax base: accounting and audit services; advertising media services; architectural services; expanded computer programs; commercial research, development, or testing services; employment agency services; engineering services; financial services; legal services; management, consulting, or public relations services; real estate brokerage and agency services; temporary labor supply services; transportation services; and veterinary services.

The Texas proposal lacked a simple and comprehensive mechanism for identifying sale-for-resale exemptions, which caused a major portion of the economic distortions associated with taxing services. The proposed legislation provided minimal sale-for-resale exemptions, including:

- a taxable service, other than a transportation service, performed on tangible personal property that is held for sale by the purchaser of the taxable service; or
- the provision of temporary labor supply services if the employee provided is directly engaged in providing a taxable service.

Table 5 presents the estimated current business sales tax on inputs in each state, the proposed change in business liability

from taxing the bundle of business services, the total business sales tax on inputs under the proposed Texas law, and the percent of the revenue increase borne by business (assuming the Texas proposal was law in all states).

Nationally, over 87 percent of the increase in tax revenue would result from increased taxes on business purchases. While the proposed Texas sales tax on services appears to be a logical extension of the sales tax, in fact it is targeted at services that are predominantly purchased by businesses, and thus has the detrimental effect of increasing the taxation of business inputs without providing the possibility of clear exemptions for resale or production.

Conclusion

The current state and local sales tax differs from a true or ideal retail sales tax and violates fundamental tax policy principles of competitiveness, fairness, simplicity, equity, and efficiency.

A true retail sales tax would impose a uniform tax only on final consumption — all goods and services sold to households — but would not impose any tax on business purchases of intermediate goods and services. All consumption by households would be taxed uniformly to avoid distorting consumption decisions. No sales tax would apply to business purchases, to avoid tax pyramiding and differential tax rates across different goods and services and different forms of business operations.

The current state and local sales and use tax system exempts a majority of consumer goods and services, while imposing more than $100 billion of sales taxes on business purchases. It is far from a true retail sales tax. The current system has significant pyramiding, or multiple taxation, of many goods and services, taxing some goods at rates significantly higher than the nominal sales tax rate and also imposing tax on goods and services that are nominally "exempt."

Expansion of the sales tax to additional business purchases would exacerbate the existing tax distortions and be adverse to states' economic development efforts.

It is important in any consideration of sales taxation of services to distinguish between services consumed predominantly by households and services purchased by businesses for use in the production of other goods and services. Expansion of the sales tax to additional business purchases would exacerbate the existing tax distortions and be adverse to states' economic development efforts. ☆